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BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

Kristin K. Mayes
Commissioner

IN THE MATTER OF THE JOINT NOTICE OF INTENT OF VERIZON COMMUNICATIONS INC. AND MCI, INC.	Docket No: T-01846B-05-0279 T-03258A-05-0279 T-03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-05-0279 T-03291A-05-0279

NOTICE OF FILING
COMMENTS ON STATE PREEMPTION

In accordance with the first ordering paragraph and Paragraph 22(b) of Decision 68348 that requires Verizon Communications Inc., to file in this docket copies of all petitions and/or comments filed at the Federal Communications Commission or with

Congress which seek preemption of state regulation, Verizon Communications Inc. submits the attached "Reply Comments of Verizon on Video Franchising" filed with the Federal Communications Commission in MB Docket No. 05-311 on March 28, 2006.

RESPECTFULLY SUBMITTED this 30th day of March, 2006.

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Docket Control – Utilities Division
1200 W. Washington Street
Phoenix, Arizona 85007

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COPY of the foregoing hand-delivered
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1723874.1

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:	)	
	)	
Implementation of Section 621(a) of the Cable Communications Policy Act of 1984 as Amended by the Cable Television Consumer Protection and Competition Act of 1992	))))	MB Docket No. 05-311
	))))	

REPLY COMMENTS OF VERIZON ON VIDEO FRANCHISING

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March 28, 2006

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REPLY COMMENTS OF VERIZON ON VIDEO FRANCHISING

The overwhelming weight of the evidence in this proceeding confirms that the local franchising process remains the single largest barrier to video competition and to increased broadband deployment, and emphasizes the need for prompt action on the part of the Commission to effectuate the pro-competitive purposes of Section 621(a) and other provisions of the Cable Act.

The record here also demonstrates the substantial benefits to consumers where wireline video competitors overcome the franchising hurdle. The Commission recently noted that "communities with overbuild competition experienced lower rates (an average of 23 percent lower for basic cable) and higher-quality service."[1] And in the communities where Verizon is already offering FiOS TV, one analyst found that incumbents responded by slashing prices by 28-42 percent in the areas where they faced competition.[2] These savings translate into massive

[1] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 05-255, FCC 06-11, ¶ 91 (rel. Mar. 3, 2006) ("*Twelfth Annual Video Competition Report*").

[2] David W. Barden and Douglas Shapiro, Bank of America Equity Research, *Battle for the Bundle: Consumer Wireline Services Pricing*, at 10 (Jan. 23, 2006).

consumer welfare gains. Commenters here estimate the loss to consumers from delaying video competition at between $8.2 billion and $21.4 billion per year.[3] Even on the low end, that equates to over $20 million dollars taken out of consumers' pockets for each day that video competition is delayed.

Unfortunately, as Verizon documented in its opening comments and the record here confirms, the current local franchising process all too often results in delay and the denial of those competitive benefits to consumers, as it has now for decades. First, the process is often marked by **inordinate delay**. As Verizon has explained, while some local franchising authorities ("LFAs") grant competitive franchises relatively quickly, Verizon's experience shows that in the vast majority of cases – over 90 percent – the process drags on for 15 months or more. And when all of the steps necessary to obtain a franchise are taken into account, the overall process generally takes 18-24 months for each community.

Also, some LFAs, often at the urging of cable incumbents, insist on **unreasonable build-out** requirements or other **unreasonable and unlawful concessions** that go beyond what the Cable Act permits an LFA to require Such requirements increase the costs – and decrease the likelihood – of competitive entry, particularly where they fail to take into account the relevant differences between providers, such as differences in network architecture or the vastly different competitive position of a new entrant facing an entrenched incumbent. And the disingenuous efforts by the cable incumbents to force these burdens on competitive providers – often citing so-

[3] *See, e.g.*, Opening Comments of Consumers for Cable Choice, at 3 (filed Feb. 13, 2006) ("*C4CC Comments*") (citing Phoenix Center study finding $8.2 billion consumer loss for one year of delay); Comments of Mercatus Center of George Mason University, at 20-21 (filed Feb. 13, 2006) ("*Mercatus Comments*") (estimating $9.6 billion to $10.5 billion annual loss); and Comments of the American Consumer Institute, at 6 (filed Feb. 13, 2006) ("*Consumer Institute*") ("over the next five years, consumers will pay $107 billion too much for cable TV services, with older consumers overpaying by $1,156 per household.").

called "level playing field" requirements that can be used to hold LFAs "hostage" – makes their claims that they want even more competition ring hollow and makes their real motivation clear.[4]

Finally, some LFAs engage in **jurisdictional overreach** by demanding, as a condition of granting a cable franchise, fees or regulatory control over *non-cable* services. Others even have suggested that once Verizon adds video to its FTTP network, the entirety of the physical network suddenly becomes a "cable system" for all purposes, and claim that this provides broad, new authority to a municipality to regulate the construction, operation and placement of a broadband network. These efforts violate the express terms of the Act and impermissibly burden competitive entry and broadband deployment.

Not surprisingly, the cable incumbents and many LFAs embrace the status quo and admit no problems with the current system. In an effort to prevent much-needed reform, these parties make several misplaced attempts to distort the relief requested by Verizon and other competitive providers, dismiss the burdens of the current franchising system, smear competitive providers with unfounded allegations of redlining or unreasonable conduct, and dress up anticompetitive policies and practices in a mantle of fairness or localism. But Verizon has made clear that it will pay franchise fees consistent with the Act, provide capacity for a reasonable number of PEG channels, comply with local laws concerning rights-of-way management, and be subject to the same federal prohibition on redlining that applies to the incumbents. And, as explained below, each of the lines of attack by opponents of reform is either a transparent attempt to forestall competition or hang on to lucrative regulatory turf.

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[4] Comments of the Greater Metro Telecommunications Consortium, et al., at 16 (filed Feb. 13, 2006) ("*GMTC Comments*"); *see also* Texas Coalition of Cities for Utility Issues' Comments on Cable Franchising NPRM, at 7-8 (filed Feb. 13, 2006) ("*Texas Coalition Comments*").

I. The Current Franchising Regime Frustrates Federal Video and Broadband Policies and Harms Consumers.

With the exception of the incumbent cable operators, nearly everyone else understands – and suffers from the ill effects of – the persistent lack of wireline video competition. Most recently, the Commission cited in its annual video competition report the recent GAO findings "that communities with overbuild competition experienced lower rates (an average of 23 percent lower for basic cable) and higher-quality service."[5] Unfortunately, as the Commission also recognized, "[r]elatively few consumers . . . have a second wireline alternative, such as an overbuild cable system." *Id.* ¶ 144. In fact, wireline competitors currently serve only about "1.5 percent of all [Multichannel Video Programming Distributor ("MVPD")] households." *Id.* ¶ 14; *see also id.* Appendix B, Table B-1. Given these stark facts, Chairman Martin acknowledged the significance of Verizon's and other traditional telcos' efforts to enter the video market by offering video over next-generation fiber networks, stating:

> [W]e are seeing wired competitors to cable trying to enter the market. The Commission should facilitate this entry, not only because it furthers video competition, but also because it promotes the deployment of the broadband networks over which the video services are provided. The widespread deployment of these networks is critical to the United States' international competitiveness. Further, it will help improve Americans' lives through applications such as distance learning and remote medical diagnostics.[6]

In fact, all of the Commissioners seem to share this understanding of the importance of encouraging video competition. Commissioner Copps remarked on the "annual story" of cable rate hikes that "out-strip[] inflation by a significant margin" – with the result that "consumers are

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[5] *Twelfth Annual Video Competition Report*, ¶ 91.

[6] Statement of Chairman Kevin J. Martin, attached to *Twelfth Annual Video Competition Report*.

feeling the pain and paying the cost and not liking it."[7] Commissioner Adelstein noted the "particular significance" of telco entry into video that promises "the most substantial new competition into the video marketplace that this country has ever seen."[8] And Commissioner Tate recognized that "[t]he significance of video competition cannot be overstated."[9]

A. Commenters Overwhelmingly Recognize the Need for Franchise Reform in Order to Increase Video Competition and Broadband Deployment.

The significance of video competition and increased broadband deployment to all segments of American society is borne out by the wide range of commenters filing in this proceeding in support of video choice. The overwhelming weight of the evidence in the record confirms that the current local franchising process creates obstacles to entry into the video market that frustrate each of the "interrelated federal goals of enhanced cable competition and rapid broadband deployment,"[10] and documents the benefits that would flow to consumers and the economy if the Commission were to remove unnecessary roadblocks to video competition.

For example, numerous consumer groups, including the Consumers Union and Consumer Federation of America, note the "skyrocketing rates" for cable services and argue that "[t]he public policy goal must be to maximize, as rapidly as possible, the benefits of new technologies and competitive markets to every American household."[11] Several commenters confirm the high

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[7] Statement of Commissioner Michael J. Copps, attached to *Twelfth Annual Video Competition Report.*

[8] Statement of Commissioner Jonathan S. Adelstein, attached to *Twelfth Annual Video Competition Report.*

[9] Statement of Commissioner Deborah Taylor Tate, attached to *Twelfth Annual Video Competition Report.*

[10] Notice of Proposed Rulemaking, *Implementation of Section 621(a) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992,* 20 FCC Rcd 18581, ¶ 11 (2005) ("*Franchise NPRM*").

[11] Comments of Consumer Union, Consumer Federation of America, and Free Press, at 1 (filed Feb. 13, 2006) ("*Consumers Union Comments*").

price tag to American consumers from delay in video competition, both in terms of "[t]he price increases [that] transfer wealth from consumers to cable firms and local governments," and the value that consumers must forego by "purchas[ing] and us[ing] less cable service in response to the price increase."[12] When both forms of harm to consumer welfare are taken into account, the Mercatus Center estimates the loss to consumers at between $9.6 billion and $10.5 billion per year. *Id.* at 20-21; *Consumer Institute Comments* at 6 ("over the next five years, consumers will pay $107 billion too much for cable TV services, with older consumers overpaying by $1,156 per household.").

Likewise, groups representing a wide cross-section of America recognize the urgent need for additional video competition. For example, numerous groups representing minority and low-income populations expressed support for removing barriers to video competition and recognized that "any unwarranted franchising delays . . . could have the effect of disadvantaging low-income and minority consumers."[13] Similarly, groups representing the residents of rural areas,[14] people with disabilities,[15] women,[16] small business owners,[17] homeowners,[18] and

[12] Comments of Mercatus Center of George Mason University, at 15 (filed Feb. 13, 2006) ("*Mercatus Comments*").

[13] Comments of the Minority Media and Telecommunications Council, et al., at 4-5 (filed Feb. 13, 2006) ("*MMTC Comments*"); *see also Comments of the League of United Latin American Citizens of the Northeast Region* (filed Feb. 13, 2006) ("FCC policy should encourage new entrants into the cable marketplace, because as competition increases, so do opportunities for Latinos"); Comments of Black Chamber of Commerce (filed Feb. 13, 2006); Comments of United States-Mexico Chamber of Commerce (filed Feb. 13, 2006); Comments of National Caucus and Center on Black Aged, Inc. (filed Feb. 13, 2006).

[14] Comments of National Grange (filed Feb. 13, 2006) ("*National Grange Comments*"); *see also* Comments of Washington State Grange (filed Feb. 13, 2006); Comments of California Farmers Union (filed Feb. 13, 2006).

[15] *See, e.g.*, Comments of American Association of People with Disabilities (filed Feb. 13, 2006); Comments of the World Institute on Disability (filed Feb. 13, 2006); Comments of American Associations of Business Persons with Disabilities (filed Feb. 13, 2006).

[16] *See, e.g.*, Comments from Women Impacting Public Policy (filed Feb. 13, 2006).

retirees[19] all recognize the need for additional video competition. In fact, even many of the LFAs that otherwise oppose franchise reform in this proceeding concede that additional video competition is needed and that "wireline competition in the delivery of multichannel video programming is the only way to discipline rates effectively." Initial Comments of the Burnsville/Eagan Telecom. Comm., et al., at 19 (filed Feb. 13, 2006) ("*Burnsville Comments*").

In addition to saving consumers money, video competition will also increase the diversity of programming available to the public. For example, the National Association of Broadcasters ("NAB") recognizes that "[t]he emergence of another platform will provide programmers unaffiliated with cable operators with an additional outlet for reaching viewers and therefore with greater opportunities for success in the marketplace," and "may also encourage the development of innovative digital television programming."[20]

The record here also confirms that video and broadband are flip-sides of the same coin, and any barriers to video competition inevitably hinder broadband deployment.[21] As Alcatel cogently explains, providing video over a broadband network "is critical for telecommunications carriers to earn sufficient revenue to justify upgrading and expanding their broadband networks. . . . [and] the next generation of broadband networks . . . will go unrealized unless the service

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[17] *See, e.g.*, Comments of the California Small Business Roundtable (filed Feb. 13, 2006); Comments of the Small Business and Entrepreneurship Council (filed Feb. 13, 2006).

[18] *See* Comments of American Homeowners Grassroots Alliance (filed Feb. 13, 2006).

[19] *See, e.g.*, Comments of TelCo Retirees Association (filed Feb. 13, 2006).

[20] Comments of National Assoc. of Broadcasters, at 2-4 (filed Feb. 13, 2006).

[21] Comments of the United States Internet Industry Assoc., at 3 (filed Feb. 13, 2006); *see also* Comments of the Discovery Institute's Technology & Democracy Project (filed Feb. 13, 2006) ("*Discovery Institute Comments*"); Comments of Ad Hoc Telecom Manufacturers Coalition (filed Feb. 13, 2006) ("*Telecom Manufacturers Comments*"); Comments of Institute for Policy Innovation (filed Feb. 13, 2006) ("*Policy Innovation Comments*"); Comments of Alliance for Public Technology (filed Feb. 13, 2006) ("*APT Comments*"); Comments of Pacific Research Institute (filed Feb. 13, 2006) ("*PRI Comments*").

provider can demonstrate to its shareholders and creditors that the revenue expectation justifies the expenditure." Comments of Alcatel, at 6 (filed Feb. 13, 2006) ("*Alcatel Comments*").[22] On the other hand, the Institute for Policy Innovation confirms that the boost to broadband deployment that come from removing regulatory barriers, observing that "it is uncanny how quickly things have accelerated once Texas deregulated the video franchise business." *Policy Innovation Comments* at 4. Therefore, the Commission must consider the impact of the current local franchising process on both federal video and broadband policy, and recognize, as several commenters note,[23] that LFAs are not well positioned to take into account and further these critical national communications policies.

B. As Incumbents Previously Recognized, the Current Franchising Process Is a Barrier to Video Competition and Broadband Deployment.

In its opening comments, Verizon documented several recurring problems with the current franchising process that delay and prevent video competition and broadband deployment, and competitive video providers of all types – ranging from large telcos like AT&T and BellSouth,[24] to CLECs like Cavalier,[25] to competitive broadband service providers like

[22] Accordingly, the incumbents and LFAs are wrong who argue that franchising does not impede broadband deployment because Verizon and other telcos possess the legal authority to deploy these broadband networks without a video franchise. *See, e.g., Comcast Comments* at 34; *Burnsville Comments* at iv. That issue is totally separate from the issue of whether incentives for investment in broadband networks exist. *See, e.g., Alcatel Comments* at 6; *Discovery Institute Comments* at 4; *Consumer Institute Comments* at 5.

[23] *See, e.g., Discovery Institute Comments* at 5 ("Local governments lack the national and global perspective needed to establish sensible communications policy in the Internet age. They also face a serious conflict of interest."); Comments of BellSouth Corporation and BellSouth Entertainment, LLC, at 27 (filed Feb. 13, 2006) ("*BellSouth Comments*") (noting that unbridled local control is "fundamentally incompatible with the national policy of increasing broadband deployment and reduced regulation of broadband networks"); Comments of AT&T Inc., at 4 (filed Feb. 13, 2006) ("*AT&T Comments*") ("local decisions cannot be expected to account for *national* goals and timelines").

[24] *BellSouth Comments*, at 10 ("The local franchising process is administratively cumbersome, slow, costly, and fraught with numerous local political perils and litigation risks."); *AT&T*

Knology,[26] to small rural telcos like South Slope Cooperative[27] – all express the same frustration with the local franchising process. While those parties with a vested interest in the current system – mostly incumbent cable operators and LFAs – may disagree,[28] the claims that the current process is conducive to competitive entry cannot be squared with the well-documented facts concerning the lack of wireline video competition.

The most disingenuous praise for the benefits of the franchising process comes from the cable incumbents, who, after decades of complaining about the franchising process, now maintain that franchising is a "simple and straightforward" process, and argue, in the name of "fair competition," that new entrants be subject to all of the same obligations and burdens as the entrenched incumbents. *Comcast Comments* at 13.[29] How quickly they forget.

Comments, at 3-4 ("The prospect that large-scale entry plans will require independent review by thousands of individual decision-makers, each with near absolute discretion to delay entry indefinitely or to impose unreasonable and unattainable conditions, is antithetical to sound communications policy.").

[25] Comments of Cavalier Tel., LLC and Cavalier IP TV, LLC, at 1 (filed Feb. 13, 2006) ("*Cavalier Comments*") ("The existing local franchising authority serves as a barrier to entry by slowing entry into a market, as well as setting unreasonable and unwieldy terms and conditions.").

[26] Comments of the Fiber-To-The-Home Council, at 22 (filed Feb. 13, 2006) ("*FTTH Council Comments*") (describing adverse impact of franchising requirements on broadband service providers like Knology).

[27] Comments of South Slope Cooperative Tel. Co., at 5 (filed Feb. 13, 2006) ("the deployment of FTTP and rollout of competitive video/triple play service is being impeded by local franchising requirements . . . [and] the costs and delays imposed by the local franchising process serve as further disincentives to competitive video entry").

[28] For example, NATOA, the National League of Cities, and the other national organization representing LFAs maintain that "LFAs nationwide welcome competition and are eager to issue additional franchises to compete with incumbent cable operators.". Comments of the National Assoc. of Telecommunications Officers and Advisors, *et al.*, at 22 (filed Feb. 13, 2006) ("*NATOA Comments*")

[29] *See also* Comments of Cablevision Systems Corp., at 2-3 (filed Feb. 13, 2006) ("*Cablevision Comments*"); Comments of National Cable & Telecom. Assoc., at 2 (filed Feb. 13, 2006)

Previously, when the existence of barriers to entry were less useful to them, the cable incumbents painted a much different picture of the local franchising process. For example, leading up to the *1972 Cable Order*, cable incumbents complained of the "confusion and waste" and the "unconscionable delay" caused by the local franchising system. 36 FCC 2d. 143 at ¶¶ 173-74 (1972). Back then, the NCTA "urged that the Commission entirely pre-empt this field." *Id.* ¶ 173.

Again a decade later, in testifying to Congress leading up to the adoption of the 1984 Cable Act, NCTA's president viewed LFAs as an obstacle to the normal operation of the marketplace, stating:

> [T]here is a basic misconception that the relationship between a city and a cable operator is that of a buyer-seller. This line of reasoning holds that any demand a city makes, however unreasonable, is just part of the normal customer-supplier negotiating process. Nothing could be further from the truth. The cable operator may be the seller but *the city is a barrier standing between a cable operator and his potential customers*. It is definitional that a barrier of that kind extracts tribute from those wishing to surmount the obstacle. The city is not the buyer of a cable service for its people. *It is, at best, the broker, through whom the seller must go if he is to ever reach his potential market. Like any broker, the city extracts a price for permitting access to the potential customer* . . . I don't know of any other private enterprise where a city can demand free services as a price of doing business.[30]

Yet these same incumbents now claim that local franchising is a "simple and straightforward" process that is essential to protect local interests and ensure fair competition.

("*NCTA Comments*") Comments of Charter Communications, Inc., at 4-5 (filed Feb. 13, 2006) ("*Charter Comments*").

[30] *Hearing on the Cable Telecommunications Act of 1983, before the Subcommittee on Communications of the Committee on Commerce, Science, and Transportation*, U.S. Senate, 98th Cong. 1st Sess., (Feb. 17, 1983) (Statement of Thomas E. Wheeler, President, National Cable Television Association) (emphasis added).

A similar latter-day embrace of the virtues of local franchising is evident in the case of the overbuilder RCN now that it has emerged from bankruptcy and lacks ambitious expansion plans that would require it to obtain additional franchises. While RCN now claims that "as a competitive provider that successfully entered the market and now is operating pursuant to dozens of local franchising agreements . . . [it] believes the current regulatory regime has worked and is working,"[31] it was not so long ago that RCN told a very different story. *See Verizon Opening Comments*, Attachment B ¶¶ 39-49 (discussing RCN's shifting views on franchising). For example, in comments filed with the Commission in 2000, RCN identified the following as "barriers to entry":

> In a large number of major urban markets, RCN has encountered within the last year local officials who seem intent on burdening RCN with ever-increasing financial and service obligations. Delays follow delays while municipal officials creatively search for new ways to extract goods, services or payments from RCN. In addition, several municipalities are delaying RCN's attempts to obtain telecommunications right-of-way agreements and/or cable franchises until RCN agrees to a franchise on its Internet services, a requirement to which other Internet service providers are not subject. RCN has been negotiating in a number of west coast markets for eight to nine months without yet seeing a definite end to the process.[32]

Furthermore, as Verizon pointed out in its opening comments, the cable incumbents viewed the imposition of legacy requirements on new entrants in a market very differently when

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[31] Comments of RCN Corporation, at 2 (filed Feb. 13, 2006) ("*RCN Comments*"); *see also* Letter from Jean L. Kiddoo, Counsel for RCN, to Marlene H. Dortch, FCC, MB Docket Nos. 05-311 and 05-192, at 1 (filed March 3, 2006) ("*RCN Ex Parte*") (providing "additional information in support of RCN's position that the local franchise process has not, in its experience, unreasonably restricted entry into the video service market").

[32] Comments of RCN Corporation, *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, CS Docket No. 00-132, at 25 (filed Sept. 8, 2000). *See also*, Minutes from a PA-COMNET Meeting on July 7, 1999: "RCN wants cities to sign agreements, not require franchises," available at http://www.pa-comnet.org/meetings /19990707-minutes.html.

they sought permission to start providing voice service. *See Verizon Opening Comments* at 39, 77. The president of NCTA once warned Congress of "state laws and regulations that appear to be 'neutral' conditions on the provision of service but [that], as historically applied, amount to barriers to new entrants." *The Communications Act of 1994: Hearing on S. 1822 Before the Senate Commerce Committee* (May 4, 1994) (statement of Decker Anstrom President and CEO National Cable Television Association). Similarly, in arguments concerning the appropriate regulatory treatment for VoIP Services, NCTA recognized the dangers of reflexively extending regulation to new competitors employing innovative technological approaches, stating:

> The strong presumption should be that regulations designed for legacy telephone service should *not* apply to VoIP services unless they are essential to meet the key public health, safety, and other crucial responsibilities . . . Experience has shown, time and again, that the best way to encourage new and innovative technologies and to secure the resulting public benefits is to ensure that only the most vital regulations apply – and even then, that those vital regulations be adapted to the characteristics of the new technology . . . The alternative – presuming that legacy regulations *do* apply, unless expressly found not to apply – is a recipe for doubt and delay. Few, if any, competitive communications technologies have ever achieved widespread market acceptance where government has followed that path; policymakers should be careful to avoid it here.[33]

Thus, the cable incumbents have no credibility when they praise the current franchising process and argue for the imposition of identical legacy regulation and burdens on new entrants, citing the mantra "like services must be treated alike." While the parties with a vested interest in limiting competition and/or preserving the status quo may be satisfied with the results of the current local franchising process, the record in this proceeding documents the tremendous barrier

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[33] NCTA Policy Paper, *Balancing Responsibilities and Rights: A Regulatory Model for Facilities-Based VoIP Competition*, at 22 (Feb. 2004) *at* http://www.ncta.com/pdf_files/whitepapers/VoIPWhitePaper.pdf.

to entry that the current franchising process poses and the negative effects of this process on video competition and broadband deployment.[34]

II. The Cable Act and First Amendment Cabin LFA Discretion in Franchising and Prohibit Many of the Common Problems with the Current Franchising Process, and the Commission Has Authority to Adopt Preemptive and Binding Rules Enforcing Those Limitations.

As Verizon explained in its opening comments, in adopting the 1992 Cable Competition Act Congress decided that consumers would benefit more from competition among video providers than from the exclusive and *de facto* exclusive franchise arrangements. *See Verizon Opening Comments* at 9-16. Accordingly, Congress imposed a significant new requirement on franchising authorities by providing in Section 621(a) that "a franchising authority may not grant an exclusive franchise and may not *unreasonably refuse to award* an additional competitive franchise." 47 U.S.C. § 541(a)(1). At the same time, in order to facilitate competition, Congress provided LFAs with a limited set of factors that they are permitted to consider in reviewing an application for a franchise, thus expressly delimiting the grounds on which an LFA may refuse to grant a competitive franchise. *Id.* Section 541(a)(4). These factors – along with several other provisions of the Cable Act – necessarily and tightly cabin the discretion of LFAs when they

[34] In another misleading effort to mischaracterize the barriers posed by the franchising process, Comcast and other incumbents selectively quote a statement from Verizon's CEO Ivan Seidenberg. *Comcast Comments* at 9; *Cablevision Comments* at 3; *RCN Ex Parte* at 1-2. Comcast conveniently omits the parts of Mr. Seidenberg's statement indicating that he was only referring to 2006, however, and these parties ignore Mr. Seidenberg's recognition in the very next sentence that there are issues that will have to be worked through with the "regulatory process," meaning franchises. *See* Thomson StreetEvents, Conference Call Transcript, *VZ-Q42005 Verizon Earnings Conference Call*, at 12 (Jan. 26, 2006) ("We don't feel that there's any impediment to our rolling out FiOS during the year, 2006. Admittedly as we go into two seven [sic] and '08, we'll need to be more aggressive because we'll be in more communities. . . . So, we do have some – some things in the regulatory process we need to work through, but I don't think there's any – any timing issue that we have to face anytime in 2006.").

consider applications for competitive franchises and limit what can be required of a competitive provider as a condition of entering the market.

Many other commenters confirm these limitations imposed by the Cable Act on the franchising process and agree with the Commission that Section 621 "established a clear, federal level limitation on the authority of LFAs in the franchising process." *Franchise NPRM* ¶ 4; *see, e.g., TIA Comments* at 6; *C4CC Comments* at 7. Indeed, while arguing that the Commission lacks authority to do anything about it, even many cable incumbents and LFAs are forced to concede Congress' pro-competitive purposes in adopting Section 621(a).[35] LFAs generally also concede that the Cable Act places limits on their discretion.[36]

Moreover, as Verizon explained earlier, the First Amendment independently requires strict limits on LFAs' discretion and imposes constraints on the franchising process, given the prior restraint on protected speech that the process effects and the huge incidental burdens that it places on such speech. *See Verizon Opening Comments* at 16-21. There is no government interest sufficient to support these burdens, particularly in the context of a provider who already has authority to deploy the network over which it intends to provide service.

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[35] *See, e.g., NCTA Comments* at 5-6 (admitting that "[a] *core purpose* of the 1992 Cable Act was to promote competition," and that Congress "sought to promote head-to-head competition among cable systems by adopting the amendments to Section 621(a)(1)" (emphasis added); *id.* at 21 (noting that Congress meant to "expressly limit[] local franchising authorities' discretion"); *Cablevision Comments* at 6 (noting that the Act supplies "defined parameters on local authority" and sets "boundaries [that] limit the scope, burdens, and duration of the franchising process").

[36] *See, e.g., NATOA Comments* at 14, 28 (conceding that "it is true that the 1992 amendments exhibit Congress' intent to place limitations on LFAs' ability to refuse to grant additional competitive franchises," and admitting that "LFAs may not impose non-cable-related requirements in franchises); *Michigan Comments* at 8 (agreeing that the Commission could find unreasonable any "LFA request for something other than that specifically authorized by Congress").

In light of these statutory and First Amendment constraints, LFA discretion must be restricted, as a threshold matter, to the limited set of factors endorsed by Congress, and any demands or conditions that go beyond those factors should be deemed per se unreasonable and prohibited. And, the Commission has authority to, and should, adopt binding and preemptive national rules that effectuate Congress' intent to foster video competition and that reconcile current franchising practices with the express requirements of the Cable Act.

A. The Commission Has Authority to Adopt Rules Enforcing the Cable Act's Limitations on Franchising Practices.

The Commission correctly recognized in the *Franchise NPRM* that it had authority to adopt binding and preemptive rules to enforce Section 621(a)'s limitations on the franchising process. *Id.* ¶ 15. Verizon explained in its opening comments that the Commission possesses general rulemaking authority to effectuate Section 621(a) as well as other provisions of the Cable Act. *Verizon Opening Comments* at 21-2; *see also AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366, 380 (1999); *City of Chicago v. FCC*, 199 F.3d 424, 428 (7th Cir. 1999) ("the FCC is charged by Congress with the administration of the Cable Act"). Moreover, the Commission has several bases for exercising preemptive authority in this context, and any rules that it adopts are binding and preemptive on LFAs. *Verizon Opening Comments* at 23-27. Among other things, Section 636 expressly preempts LFA actions or franchise agreements that are "inconsistent with this Act." 47 U.S.C. § 556. The record here overwhelmingly supports the Commission's authority to adopt binding and preemptive rules in this context.[37]

[37] *See, e.g., Mercatus Comments* at 32-33 ("has several sources of authority to preempt local franchising rules that hinder competition . . . [and in doing so] would be acting consistent with the Act and within its delegated authority"); *Alcatel Comments* at 12-19; *FTTH Council Comments* at 47-56; *Telecommunications Manufacturers Comments* at 6; *NAB Comments* at 5-6; Comments of Microsoft Corporation, at 7 (filed Feb. 13, 2006) ("*Microsoft Comments*"); *AT&T*

Despite the widespread agreement that Congress intended to limit LFA discretion and encourage video competition when it amended Section 621(a) with the 1992 Cable Competition Act, the incumbents and LFAs argue that the Commission lacks authority to enforce these limitations and adopt rules to achieve the goals that Congress intended. This restricted view of the Commission's jurisdiction is inconsistent with the Cable Act and with the Commission's well-recognized authority to adopt rules to effectuate Congress' purposes.

1. There Is Nothing Unique About Franchising Requirements That Deprive the Commission of Jurisdiction.

The first argument by these parties is that Congress decided that franchising in general, and Section 621(a) in particular, should be left peculiarly in the control of LFAs, and that federal oversight or enforcement of these provisions of the Cable Act are off limits for the Commission. For example, relying on the legislative history of the 1984 Cable Act, some LFAs argue that "Congress reserved authority over the franchising process, almost in its entirety, to LFAs, not to the Commission." *NATOA Comments* at 13; *see also Michigan Comments* at 5-6; *Montgomery County Comments* at 30-31; *Comcast Comments* at 32. The position urged by these parties would suggest that the 1992 Cable Competition Act did not alter the legal and competitive landscape. As Verizon explained in its opening comments, while the facts on the ground may not have changed much since 1992, Congress fully intended to place significant limitations on LFA discretion when it amended Section 621(a) in order to facilitate competitive entry into the video market. *See Verizon Opening Comments* at 9-16.

1. The Commission has well-recognized authority to adopt binding and preemptive rules enforcing all parts of the Cable Act, including Section 621(a). Indeed, the Commission has

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Comments at 32-39; *BellSouth Comments* at 47-67; *USTelecom Comments* at 11-17; *South Slope Comments* at 11-12.

already interpreted portions of Section 621 on several occasions, and its authority to do so has consistently been upheld. For example, the Seventh Circuit rejected similar arguments that the Commission lacks authority with respect to franchising issues in *City of Chicago v. FCC*, 199 F.3d at 428. The court confirmed there that "the FCC is charged by Congress with the administration of the Cable Act," and concluded that the court was "not convinced that for some reason the FCC has well-accepted authority under the Act but lacks authority to interpret § [621]." *Id.* Similarly, the D.C. Circuit has upheld two Commission orders interpreting the franchising requirements of Section 621. *See NCTA v. FCC*, 33 F.3d 66, 70 (D.C. Cir. 1994) (upholding Commission order determining that Section 621 franchise requirements did not apply, and construing statutory definitions of "cable service," "cable operator," and "cable system"); *ACLU v. FCC*, 823 F.2d 1554 (D.C. Cir. 1987) (affirming Commission's "interpretative rules" concerning the anti-redlining provision of Section 621(a)(3)). Therefore, the Commission's authority to adopt rules interpreting and enforcing the Cable Act's franchise provisions is beyond question.

Moreover, as the Supreme Court has confirmed, "'Commission jurisdiction' always follows where the Act 'applies,'" and the Commission has general rulemaking authority to prescribe rules governing such matters. *See Iowa Utilities Bd.*, 525 U.S. at 380 (citing 47 U.S.C. § 201(b)); *see also id.* (emphasizing that the grant of rulemaking authority in Section 201(b) applies to all "provisions of the Act," and is not limited to matters which involve interstate or foreign communication, or which involve common carriers). And the Commission's "prescription, through rulemaking" is binding and preemptive on state and local governments who may "apply those standards and implement that methodology," but may not disregard the Commission's interpretation of federal law. *Id.* at 384. Because Congress expressly directed that the 1984 Cable Act, the 1992 Cable Competition Act, and 1996 Act be inserted into the Communications Act of 1934, the Commission's rulemaking authority extends to implementation of the cable television franchising provisions added by these more recent statutes. *See id.* at 377-78.

Under Section 621(a)(1), an LFA has the authority, in the first instance, to award franchises. Under *Iowa Utilities Board*, however, the fact that the Act "entrusts" a state or local agency with a particular responsibility "do[es] not logically preclude the Commission's issuance of rules to guide the state-[authority] judgments." 525 U.S. at 385. In fact, the Supreme Court has expressed "no doubt . . . that if the federal courts believe a state commission is not regulating in accordance with federal policy they may bring it to heel." *Id.* at 379 n.6. The debate, then, is "not about whether the States will be allowed to do their own thing, but about whether it will be the FCC or the federal courts that draw the lines to which they must hew." *Id.*

2. Moreover, there is no merit to the suggestion of some parties that the Commission lacks preemptive authority in this context. *See, e.g., Burnsville Comments* at 28-33; *Comcast Comments* at 36-40. As Verizon explained in its opening comments, several, independent bases for preemptive authority apply here. *See Verizon Opening Comments* at 23-27.

As an initial matter, some parties suggest that the Commission cannot exercise binding and preemptive rules here because the Act does not "specifically direct" the Commission to do so. *See, e.g., NCTA Comments* at 1-2; *NATOA Comments* at 10. That has never been the standard. When acting within its authority, the Commission may preempt state and local laws addressing the regulation of cable services. And the Supreme Court has long made clear that "[f]ederal regulations have no less pre-emptive effect than federal statutes." *Capital Cities Cable v. Crisp*, 467 U.S. 691, 699 (1984) (citation and quotation omitted). Indeed, in this particular context the Supreme Court has stated that "if the FCC has resolved to pre-empt an area of cable television regulation and if this determination 'represents a reasonable accommodation of conflicting policies' that are within the agency's domain, we must conclude that all conflicting state regulations have been precluded." *Id.* at 700 (internal citation omitted).

The preemptive effect of federal law in this context is particularly clear in light of the express preemption provision included in the Cable Act. Section 636 states that "any provision of law of any State, political subdivision, or agency thereof, or franchising authority, or any provision of any franchise granted by such authority, which is inconsistent with this Act *shall be deemed to be preempted* and superseded." 47 U.S.C. § 556 (emphasis added). Thus, states and municipalities are not permitted to act in a manner inconsistent with the Commission's valid interpretations of the Cable Act. *See, e.g., Liberty Cablevision of Puerto Rico, Inc. v. Municipality of Caguas*, 417 F.3d 216 (1st Cir. 2005) (holding municipal franchise fee provisions preempted by Section 636 because inconsistent with Section 622); *City of Chicago v. AT&T Broadband, Inc.*, No. 02-C-7517, 2003 U.S. Dist. LEXIS 15453, at *6 (N.D. Ill. Sept. 4, 2003) (finding that Section 636 required preemption of local franchising agreements that would require payment of franchise fees on cable modem service, in light of Commission's determination that cable modem service was not a "cable service"); *MediaOne Group, Inc. v. AT&T Corp.*, 97 F. Supp. 2d 712 (E.D. Va. 2000) (finding several provision of local ordinances preempted under Section 636 where contrary to various provisions of the Cable Act).

In fact, even before the Act was amended to include Section 636, the Commission recognized its broad preemptive power with respect to the regulation of cable services, and the "deliberately structured dualism" of federal and state jurisdiction. *1972 Cable Order*, 36 F.C.C.2d 143, ¶ 177 (1972). Given the "limited resources of states and municipalities and [its] own obligation to insure an efficient communications service with adequate facilities," the Commission recognized that it "must set at least minimum standards for franchises issued by local authorities." *Id.* There, in preempting the high franchise fees imposed by many local authorities, the Commission expressed its concern that "high local franchise fees may burden cable television to the extent that it will be unable to carry out its part in our national communications policy." *Id.* ¶ 185. Similarly here, the delay and other unreasonable burdens commonly associated with obtaining a competitive franchise frustrate the national communications policies of encouraging video competition and broadband deployment. The Commission's authority to preempt unreasonable provisions or actions by LFAs that frustrate federal communications polices – which already was clear when the Commission promulgated the *1972 Cable Order* – has been made even clearer with Section 636's express preemption provision.

Finally, contrary to the suggestion of some parties,[38] the Fifth Circuit's decision in *City of Dallas v. FCC*, 165 F.3d 341 (5th Cir. 1999), does not undermine the Commission's preemptive authority here. First, the court expressly recognized in that case that Section 621 "place[s] limits on the conditions and restrictions a local franchising authority may impose," and also recognized that Section 621 "*restricted* local governments' independently-existing authority to impose franchise requirements." *Id.* at 348-49 (emphasis added). This proceeding addresses precisely those restrictions that the court recognized Section 621 imposes on LFAs.

Second, because Congress said in the 1996 Act that Section 621 did *not* apply to "open video system" providers, 47 U.S.C. § 573(c)(1)(C), the issue before the court was whether local

[38] *See Comcast Comments* at 37-38; Comments of the Public Cable Television Auth., at 12-15 (filed Feb. 10, 2006) ("*PCTA Comments*").

governments have the authority to impose franchising obligations where Section 621(a)'s federal franchise requirement *does not* apply. It was only because Section 621's preemptive limits on franchising did not apply to OVS that the court found that localities could still act. *City of Dallas*, 165 F.3d at 347. Therefore, that case has no bearing on the limitations that Section 621(a) itself imposes on LFAs and no parties suggest that Section 621(a)'s limitations do not apply here or that LFAs may ignore those limitations.[39]

Moreover, the court's decision in *City of Dallas* was based, in part, on Section 601 of the 1996 Act, which is a savings clause that indicated that the *1996 Act* and its amendments to the Cable Act were not intended to impliedly preempt state or local law. *See id.* at 346 (citing Section 601).[40] Despite the suggestion of some parties to the contrary,[41] that provision on its face does not apply to the restrictions of Section 621(a) which were adopted as part of the 1992 Cable Competition Act. In any event, that provision addresses only *implied* preemption; in this context, Section 636 of the Communications Act *expressly* preempts state laws that are contrary to federal law, including Section 621(a). 47 U.S.C. § 556(c) ("[A]ny provision of law of any State, political subdivision, or agency thereof, or franchising authority, or any provision of any franchise granted by such authority, which is inconsistent with this Act shall be deemed to be preempted and superseded."). Thus, the Commission has authority to adopt binding and preemptive rules to enforce Section 621(a) and other provisions of the Cable Act.

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[39] *See* Comments of Qwest Communications Int'l Inc., at 17 n.33 (filed Feb. 13, 2006) ("*Qwest Comments*").

[40] Section 601, which was not codified in the Communications Act, stated with reference to the 1996 Act that "[t]his Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, Staet, or local law unless expressly so provided in such Act or amendments." Section 601(c)(1) of the 1996 Act, Pub. L. No. 104-104, 110 Stat. 56.

[41] *Michigan Comments* at 11.

2. Section 621(a)'s Judicial Review Provision Does Not Deprive the Commission of Authority to Adopt Rules.

A second line of attack by some LFAs and incumbents is the argument that even if Congress intended to place meaningful limits on LFA discretion, it did not intend for the Commission to have any say in how LFAs make franchising decisions, but instead meant for courts to be the only available recourse. *See, e.g., NATOA Comments* at 5-16; *NCTA Comments* at 19-26; *Comcast Comments* at 27; *Michigan Comments* at 4. And some of these parties go so far as arguing that LFAs could act as unreasonably as they want without triggering any remedy for the competitive provider, so long as the LFA does not deny the application outright. *See, e.g., NATOA Comments* at 8, 30-31. These parties read too much into Section 621(a)'s judicial review provision, however, while ignoring the Commission's authority to adopt binding rules enforcing the Act, even when judicial review exists.

1. The existence of judicial review provisions within the Communications Act has never been a basis for depriving the Commission of its authority to adopt rules that effectuate the purposes of the Act. For example, when telecommunications carriers are unable to agree on negotiated terms for interconnection, Section 252 sets out an elaborate set of arbitration proceedings involving state commissions, and then provides for ultimate review by federal district courts. *See* 47 U.S.C. § 252(a)-(e). Despite this structure, the Supreme Court upheld the Commission's authority to adopt rules that are binding on both the state commissions and the courts as they review these arbitration decisions. *See Iowa Utilities*, 525 U.S. at 385 ("None of the statutory provisions that these rules interpret displaces the Commission's general rulemaking authority.").

The same is certainly true here. The Commission has well-recognized authority to adopt rules to enforce the Cable Act,[42] and the existence of a provision permitting judicial review of the LFAs' decisions does not diminish that authority. Instead, the Commission's rules adopted under its general rulemaking authority are a source of federal law, in addition to the statute, and those rules are binding and preemptive.

Moreover, Commission rulemaking here would not in any way undermine the statute's judicial review provision. Instead, any rules adopted by the Commission would be complementary to that provision, providing an additional, binding body of federal law that would have the salutary effects of creating binding *ex ante* rules to guide LFAs and would provide courts with an additional source of federal law by which to judge an LFA's actions. Thus, the judicial review provision does not diminish the Commission's authority to effectuate the purposes of Section 621(a) by adopting binding and preemptive rules.

2. Equally flawed is NATOA's claim that the judicial review provision would deny deference to any Commission rules adopted under Section 621(a)(1) because the Commission's jurisdiction would be "only concurrent with the jurisdiction of the courts." *NATOA Comments* at 20.

NATOA's argument fails as a matter of law. After a federal agency interprets a statutory provision, courts addressing the same question in a subsequent case routinely respect the agency's earlier ruling. *See, e.g., National Cable & Telecommunications Ass'n v. Brand X Internet Services*, -- U.S. --, 125 S.Ct. 2688, 2700 (2005) (deferring to FCC's interpretation of "telecommunications service," because "it is for agencies, not courts, to fill statutory gaps").

[42] *See, e.g., City of Chicago*, 199 F.3d at 428 ("the FCC is charged by Congress with the administration of the Cable Act").

Finally, NATOA's reliance on *Kelley v. E.P.A.*, 15 F.3d 1100, 1108 (D.C. Cir. 1994) is misplaced.[43] The issue in *Kelley* was the EPA's authority to interpret a statutory provision that governed the EPA's own ability to bring civil actions in court to recover its costs associated with the cleanup of hazardous wastes from those responsible for the contamination. Pursuant to the statute, the EPA needed to prove that the defendant was an "owner or operator" of a contaminated site, and in that case the EPA had issued an interpretive rule defining the types of "owners and operators" that were exposed to liability, thereby easing its own burden in civil prosecutions. The D.C. Circuit refused to defer to the agency's rule in that context because "[w]here Congress ... gives the agency authority *only* to bring the question to a federal court as the 'prosecutor,' deference to the agency's interpretation is inappropriate," and under the statutory regime at issue, "that is all that EPA can do regarding liability issues." *Id.* at 1108 (emphasis added). Thus, the holding in that case on which NATOA relies is inapposite in this context, and the judicial review provision has no bearing on the Commission's authority to adopt binding rules enforcing Section 621(a).

3. There Is No Constitutional Impediment to Commission Rulemaking.

Finally, some LFAs claim that the Constitution – and in particular the Fifth and Tenth Amendments – deprive the Commission of authority to adopt rules to effectuate Congress' pro-competitive purposes in Section 621(a) and other provisions of the Cable Act. These arguments also fail.

1. First, certain parties suggest that "any attempt" by the Commission to limit local franchising authority by adopting rules enforcing Section 621(a) would be invalid because it

[43] NATOA also cites *Adams Fruit Co. v. Barrett*, 494 U.S. 638 (1990), but that case also does not apply here. There, the Court held that the agency's interpretation was not entitled to *Chevron* deference because it was in conflict with the "plain meaning" of the statute. *Id.* at 646-50.

would result in a taking of localities' property interest in public rights-of-way in violation of the Fifth Amendment.[44] As an initial matter, these takings claims are entirely misdirected. The Cable Act itself expressly limits local authority by stating that a local franchising authority "may not unreasonably refuse to award an additional competitive franchise." 47 U.S.C. § 541(a)(1). If a taking exists, it results from the Act, and these commenters have not sought to invalidate the Act itself. Instead, as discussed above, many LFAs concede the Act's legitimate constraints on LFA franchising decisions. Accordingly, the commenters' takings theory provides no basis for limiting the Commission's authority to give meaning to the limit imposed by the Act.

These takings arguments also lack merit for several different reasons. The impact on any municipal property interest from permitting a telecommunications carrier to offer video service is nonexistent because such carriers have an independent right under state law to occupy rights-of-way. Because all municipal power is derived from the state,[45] a municipality is not entitled to compensation when its interests in the streets are taken pursuant to state law.[46] States have granted franchises to telecommunications carriers, pursuant to which the carriers lawfully occupy public rights-of-way for the purpose of providing telecommunications service. The transmission of additional video signals along those same lines results in no physical occupation of public rights-of-way beyond that already permitted by the states. *See C/R TV, Inc. v. Shannondale, Inc.*, 27 F.3d 104, 109 (4th Cir. 1994) (reasoning that the transmission of cable television signals "would not impose an additional burden on [a] servient estate" on which telephone poles, power

[44] *See Burnsville Comments* at 38-41; *see also Michigan Comments* at 10; *Montgomery County Comments* at 37.

[45] *See St. Louis v. Western Union Telegraph Co.*, 149 U.S. 465, 467 (1893); *Liberty Cablevision*, 417 F.3d at 221.

[46] *See City & County of Denver*, 18 P.3d at 761; 4A Nichols on Eminent Domain § 15.02[2] (2005).

lines, and telephone wires had previously been installed); *cf. Ala. Power Co. v. FCC*, 311 F.3d 1357, 1369 (11th Cir. 2002) (discussing the unique takings issues presented when "use by one entity does not necessarily diminish the use and enjoyment of others"). There is no incremental burden on public rights-of-way resulting from the use of existing telecommunications facilities to provide cable service, and thus no taking.[47]

Moreover, a fundamental problem with the LFAs' takings argument is that LFAs do not have a proprietary ownership interest in public rights-of-way. While the takings clause protects property owned by the government in a proprietary capacity, it does not extend to property, such as rights-of-way, that the government regulates in a governmental capacity. Thus, in *Liberty Cablevision of P.R., Inc. v. Municipality of Caguas*, 417 F.3d 216, 221-22 (1st Cir. 2005), the court rejected the suggestion that municipalities "are entitled to compensation as 'owners' of these rights-of-way." The court relied on precedent holding that "the ownership interest municipalities hold in their streets is 'governmental,' and not 'proprietary,' and thus municipalities are not necessarily entitled to compensation." *Id.* at 222.[48] Even if municipalities hold title to rights-of-way, they "generally possess no rights to profit from their streets unless specifically authorized by the state." *Id.* Accordingly, a municipality generally does not have a compensable ownership interest in public rights-of-way. *Id.; see also City & County of Denver*

[47] And, in any event, the Act obligates cable operators to pay a franchise fee of up to 5% of gross revenue from the provision of cable service. 47 U.S.C. § 542(b). Commenters have not suggested (much less proven) that such franchise fees fail to represent more than adequate compensation for the use of public rights-of-way. *See U.S. v. Riverside Bayview Homes*, 474 U.S. 121 (1985).

[48] *See also New Jersey Payphone Association v. Town of West New York*, 130 F. Supp. 2d 631, 638 (D.N.J. 2001) ("the control the municipality exerts over the easement is a function of its powers as trustee, conventionally expressed as the police power to manage the public right-of-way … the municipality does not possess ownership rights as a proprietor of the streets and sidewalks"), *aff'd*, 299 F.3d 235 (3d Cir. 2002); *see also* Gardner F. Gillespie, *Rights-of-Way*

v. Qwest Corp., 18 P.3d 748, 761 (Colo. 2001) (en banc). Accordingly, the takings theory should be disregarded.[49]

2. Second, some LFAs also maintain that the Commission could run afoul of the Tenth Amendment by adopting rules governing an LFA's exercise of its franchising authority. *See, e.g., Montgomery County Comments* at 37; *Michigan Comments* at 24-26. This argument also lacks merit.

When Congress acts within the scope of its Commerce Clause authority, it is entitled under the Supremacy Clause to preempt state laws and doing so presents no issue under the Tenth Amendment. *City of New York v. FCC*, 486 U.S. 57, 63 (1988). This is so for the simple reason that, "[i]f a power is delegated to Congress in the Constitution, the Tenth Amendment expressly disclaims any reservation of that power to the States." *New York v. United States*, 505 U.S. 144, 156 (1992). And the Supreme Court long ago recognized that Congress – and by extension the Commission – have authority under the Commerce Clause to regulate cable services.[50] *See Crisp*, 467 U.S. at 700-701 (holding that cable services are interstate services).

Redux: Municipal Fees on Telecommunications Companies and Cable Operators, 107 Dick. L. Rev. 209, 212-15 (2002).

[49] One LFA also suggests that the proposed regulations "could deprive the LFAs and other franchising authorities of lawful and reasonable compensation they negotiated with incumbent cable operators for the use of the public rights-of-way," raising additional takings issues. *Burnsville Comments* at 40. This suggestion is too speculative to deprive the Commission of jurisdiction because this LFA has failed to demonstrate that the impact of the Commission's action would be so dramatic as to constitute a regulatory taking. *See, e.g.*, *Penn Central Transportation Co. v. New York City.*, 438 U.S. 104, 135-38 (1978). As noted, any such remote possibility does not justify a narrowing of the Commission's rulemaking authority. *Riverside Bayview* , 474 U.S. at 128.

[50] For this reason, the arguments made by several LFAs concerning their authority to grant cable franchises or manage the rights-of-way pursuant to state law miss the mark. *See, e.g., Michigan Comments* at 28-45; *Montgomery County Comments* at 24-30. Where Congress and the Commission have authority under the constitution to adopt laws or regulation, the Supremacy Clause does not permit contrary state laws to stand in the way.

For example, in *Crisp*, the Court upheld the FCC's broad preemption of state and local cable regulations that conflicted with its own "uniform national communications policy with respect to cable systems" that had been adopted "in order to assure the orderly development of [cable] technology into the national communications structure."[51]

For the same reasons that Congress has authority to regulate video providers under the Commerce Clause, the Tenth Amendment poses no obstacle to federal preemption of state and local franchise laws or practices. The Tenth Amendment provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const., Amend. X. The Supreme Court has recognized that the Tenth Amendment states a relatively unremarkable "truism" that does nothing to diminish Congress' power when legislating under its enumerated powers. *New York*, 505 U.S. at 156 ("If a power is delegated to Congress in the Constitution, the Tenth Amendment expressly disclaims any reservation of that power to the States; if a power is an attribute of state sovereignty reserved by the Tenth Amendment, it is necessarily a power the Constitution has not conferred on Congress.").[52] So, for example, the Supreme Court has rejected a municipality's effort to use its police powers to impose more restrictive regulations on a cable system than permitted under the FCC's rules, recognizing that "when federal officials determine . . . that

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[51] *Id.* at 703, n.8 & 714; *see also City of New York*, 486 U.S. at 60-64 (upholding federal authority to preempt state and local cable regulations); *Qwest Broadband Services, Inc. v. City of Boulder*, 151 F. Supp.2d 1236, 1245 (D. Colo. 2001) (upholding federal authority to preempt provisions of local franchising law, and recognizing that "Congress can regulate communications pursuant to the Commerce Clause").

[52] *See also Qwest Broadband*, 151 F. Supp.2d at 1245 ("a holding that a Congressional enactment does not violate the Commerce Clause is dispositive of a Tenth Amendment challenge").

restrictive regulation of a particular area is not in the public interest, States are not permitted to use their police power to enact such a regulation."[53]

The Tenth Amendment does restrict Congress' ability to "simply 'commandeer the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program.'" *New York*, 505 U.S. at 161 (citation omitted), or to commandeer the states' executive officials to enforce federal regulations. *See Printz v. United States*, 521 U.S. 898, 933 (1997). But the Supreme Court has concluded that the Tenth Amendment poses no problem where Congress or the FCC gives states "the choice of regulating . . . activity according to federal standards or having state law pre-empted by federal regulation." *New York*, 505 U.S. at 167. So, for example, the franchise fee provisions of the Cable Act have been upheld against a challenge of "commandeering" because the statutory provision "does not require the States to regulate cable operators, it merely places a cap on the amount of franchise fees that can be collected under a cable franchise agreement, if the City chooses to regulate cable operators." *City of Chicago v. AT&T Broadband, Inc.*, 2003 U.S. Dist. LEXIS 15453, at * 16 (N.D. Ill. 2003). Thus, the Tenth Amendment does not prevent the Commission from adopting binding and preemptive rules enforcing the Cable Act and preventing LFAs from frustrating federal communications policies.[54]

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[53] *Crisp*, 467 U.S. at 708 (citation and quotation omitted); *see also New York*, 486 U.S. at 67-70 (upholding FCC preemption of local signal quality standards for cable systems).

[54] Tellingly, the LFAs have not challenged the restrictions on their authority imposed by the Act as inconsistent with the Tenth Amendment. The LFAs have failed to explain how the Commission's interpretation of those standards would raise any Tenth Amendment concern that is not presented by the Act itself.

4. Commission Rules Can Provide Meaningful Consequences to LFA Actions that Unreasonably Prevent Video Competition.

In light of its well-founded authority to enforce the pro-competitive provisions of the Cable Act, the Commission should adopt the rules that Verizon suggests in its opening comments, including binding and preemptive rules to prevent unreasonable delay or other unreasonable overreaching that frequently occurs during the franchising process.

In particular, in order to effectuate Section 621(a)'s purpose of facilitating competitive entry and keeping the franchising process moving, the Commission should adopt specific time limits to prevent unreasonable delay. And to give effect to that determination, the Commission should adopt a mechanism that would attach consequences to LFA inaction and further the purposes of Section 621(a) – namely, allowing a competitive provider to start offering video services whenever an LFA fails to act on a competitive franchise application within the defined, reasonable period of time. In adopting this approach, the Commission could require the provider to continue negotiations with an LFA towards agreement on a final franchise, even after it starts offering service. Thus, LFAs would retain their important role in franchising and would still be able to protect any legitimate local interests. But, unlike the current process which allows LFAs to deprive the provider of the right to offer video service – and hence engage in protected First Amendment speech – for an unreasonably long period, this approach also would further Congress' goal of encouraging competitive entry and prevent LFAs and incumbents from using delay as a tool to force unreasonable or unlawful concessions as a condition of entry.

This approach is perfectly consistent with the text of the Cable Act. Given the Commission's authority to enforce and effectuate the purposes of the Cable Act,[55] the

[55] *See, e.g., City of Chicago*, 199 F.3d at 428 ("the FCC is charged by Congress with the administration of the Cable Act").

Commission's authority is broad enough to adopt binding and preemptive rules that allow a competitive provider to start offering video service when an LFA acts contrary to federal law. And to the extent that this interim authority for a competitive provider to start offering service is akin to a franchise – the Commission has authority to adopt rules to provide for that as well. Indeed, while the Act requires a cable operator to obtain a franchise before providing cable service, 47 U.S.C. § 541(b)(1), nothing in the Act provides state or local governments with an *exclusive* right to issue franchises, and the Act instead expressly limits an LFA's authority and requires that it be exercised in accordance with federal law. In fact, the Cable Act's definition of "franchising authority" includes not only state and local governments, but instead "*any* governmental entity empowered by *Federal*, State, or local law to grant a franchise." 47 U.S.C. § 522(10) (emphasis added).

Thus, the Commission has authority to promulgate rules guiding an LFA's judgment, and creating meaningful consequences – including authorizing a competitive provider to start offering cable services – in response to LFA inaction or overreaching that violates federal law. *See Iowa Utilities Bd.*, 525 U.S. at 385; *see also 1972 Cable Order*, ¶ 177.[56]

[56] In fact, regulation and possible preemption of state or local policy would not be unique to the Commission. To the contrary, the Department of Health and Human Services (DHHS) has promulgated a similar regulation in interpreting the Social Security Act, 42 U.S.C. §§ 301-1397jj. Section 1932 of the Social Security Act provides that "the State . . . shall permit an individual . . . enrolled with the entity under this title to terminate (or change) such enrollment (i) for cause at any time . . . , and without cause (I) during the 90-day period beginning on the date the individual receives notice of such enrollment, and (II) at least every 12 months thereafter." 42 U.S.C. § 1396u-2(4)(A). DHHS, in interpreting Section 1932, established a timeframe for determination of enrollees' requests to terminate their enrollment: "the effective date of an approved disenrollment must be no later than the first day of the second month following the month in which the enrollee . . . files the request." 42 C.F.R. § 438.56(e)(1). DHHS also imposed a consequence for the State or other responsible agency's failure to make the determination within this timeframe. If the organization, health plan, case manager or "the State agency (whichever is responsible) fails to make the determination within the timeframe specified in paragraph (e)(1) of this section, the disenrollment is considered approved." *Id.* § 438.56(e)(2).

5. The Commission Also May Adopt Rules and Interpretations Addressing Other Parts of the Cable Act.

Finally, there is no dispute that the Commission has authority to adopt binding rules and interpretations enforcing other provisions of the Cable Act. As Verizon noted in its opening comments, many of the persistent problems with the current franchising process stem from demands from LFAs that are contrary to the express terms of the Cable Act. For example, some LFAs demand excessive fees or other in-kind assessments that violate the Cable Act's franchise fee provisions. *See Verizon Opening Comments* at 51, *et seq*. Likewise, some LFAs demand unreasonable PEG and I-Net commitments beyond what the Cable Act authorizes, or adopt unreasonable definitions of the term "franchise area" when making build-out demands. *See id.* at 41-51 & 64-80. Still others have suggested that they might adopt an expansive definition of the term "cable system" in order to exercise broad, new authority over mixed-use, broadband networks once video is added to them. *See id.* at 80-89.

The Commission has authority to address and enforce these other provisions of the Cable Act, separate and apart from its authority under Section 621(a), and courts have repeatedly upheld the Commission's authority to do so.[57] In fact, even NATOA concedes that the Commission has authority to "constru[e] the definitions set forth in § 602 of the Act." *NATOA Comments* at 16. Thus, although the Commission has ample authority to adopt binding and preemptive rules enforcing Section 621(a), it also has authority to adopt complementary rules

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The franchising provisions of the Cable Act lend themselves to a similar interpretation.

[57] *See, e.g., City of Chicago*, 199 F.3d at 427-28 (upholding Commission's interpretation of the term "cable system"); *NCTA*, 33 F.3d at 70 (upholding Commission order determining that Section 621 franchise requirements did not apply, and construing statutory definitions of "cable service," "cable operator," and "cable system"); *ACLU*, 823 F.2d at 1554 (affirming Commission's "interpretative rules" concerning the anti-redlining provision of Section 621(a)(3)); *City of Dallas*, 165 F.3d at 351 (upholding Commission's conclusion that Section 611 does not authorize LFAs to require construction of I-Net).

and interpretations of several other provisions and terms in the Cable Act in order to address many of the recurrent problem areas with the current franchising process.

III. The Commission Should Adopt Rules To Address Several Common Local Franchising Practices that Violate Section 621(a) and Other Provisions of the Cable Act and the Constitution.

In light of the robust record now before the Commission documenting the barriers to video competition and broadband deployment created by the current local franchising regime, the Commission should adopt the rules proposed by Verizon in its opening comments to streamline the process by addressing several recurring problem areas.

Notwithstanding the strawman arguments and scare tactics of some opponents of reform,[58] the rules that Verizon has proposed that the Commission adopt are firmly grounded in the current statutory structure, and do not undermine any legitimate local interests related to franchising. In fact, even when Verizon has advocated broader franchise reform in the legislative context, it consistently has indicated that legitimate local interests must be protected. For example, in recent testimony to a Senate panel considering franchise reform, Verizon's CEO clearly stated that any franchise reform proposal should (1) require new entrants to pay franchise fees and (2) carry PEG channels; (3) preserve local authority to manage public rights-of-way, and (4) subject new entrants to the same federal anti-redlining prohibition that now applies to the incumbents.[59] Therefore, the Commission should not be distracted by false claims about the relief that Verizon is seeking, and should act quickly to adopt rules that will improve the current

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[58] *See, e.g.,* Comments of the City of Los Angeles, California, at 1 (filed Feb. 9, 2006) ("*Los Angeles Comments*") (suggesting that telcos are "attempting to avoid payment of franchise fees, local control over public rights-of-way, Public, Educational and Government (PEG) obligations and other necessary local franchise obligations").

[59] *Video Franchising, Hearing before the Senate Commerce Committee* (Feb. 15, 2006) (statement of Ivan Seidenberg, Chairman and CEO, Verizon, at 4-5).

franchising process and bring the benefits of video competition and widespread broadband deployment to consumers.

A. The Commission Must Prevent Unreasonable Delay.

One problem that plagues the current franchising process is delay. *See Verizon Opening Comments* at 30-38. As Verizon explained its opening comments, and the record confirms, several different factors contribute to this delay. The problem of delay results in part from factors such as inertia, arcane or lengthy application procedures, bureaucracy or, in some cases, inattentiveness or unresponsiveness by the LFA. In other cases, delay is used by municipalities as a negotiating tactic in an effort to force Verizon to agree to unreasonable, and often unlawful, conditions or concessions. And delay is nearly always increased as a result of the efforts of incumbent cable operators to forestall the onset of video competition using any means available. Section 621(a), by its very terms, was intended to prohibit unreasonable delay in the franchising process.

1. The Current Process Produces Unreasonable Delays.

Verizon's experience over the last two years reveals that some LFAs are anxious to welcome video competition, and are able to efficiently and expeditiously complete the franchising process. These LFAs prove that the franchising process need not be a protracted one. Unfortunately, these examples currently are a distinct minority, and unreasonable delay – of 15 months or more in Verizon's experience to date – is the rule rather than the exception, while the entire process can easily take 18-24 months to complete:[60]

- With respect to the 46 negotiations (outside of Texas) that were ongoing as of 15 months ago – that is, as of December 28, 2004 – Verizon has received only 6 franchises to date, and three of those six took 15 months or more to complete. In

[60] Letter from Leora Hochstein, Verizon, to Marlene Dortch, FCC, MB Docket No. 05-311 (filed March 8, 2006) ("*March 8 Ex Parte*").

other words, well over 85 percent of those negotiations pending 15 months ago are still not complete, and over 90 percent took or have already taken 15 months or more.

- Similarly, of the 113 negotiations that were ongoing as of 12 months ago – March 28, 2005 – only 10 franchises have since been granted.[61] In other words, well over 90 percent of the negotiations pending a year ago are not complete.

While LFAs almost uniformly claim that their own franchising procedures and practices are reasonably efficient, LFAs' comments in this proceeding reveal a wide range of what they consider "reasonable," and several provide evidence confirming the types of unreasonable delay that are now common. For example, in making a qualified endorsement of the need for franchise reform, the City of Indianapolis "recommends that the process be limited to six to nine months *versus what has been a three-year process.*" *Indianapolis Comments* at 8 (emphasis added); *see also Michigan Comments* at 14 (noting that "[o]ne could see how the 120 day timeframe might be a workable 'best practice' deadline where a competitive franchisee presents an LFA with a proposal to meet the terms of the existing franchise" and suggesting that three years would be more appropriate than 120 days where a "competitive franchisee seek[s] a tailored franchise"). In another set of comments filed jointly by several LFAs, one LFA boasted that in its experience, negotiating with competitive providers has "generally taken a year or less," while another LFA agreed that "competitive franchises have taken approximately 12 months to negotiate."[62] And the City of Chicago similarly concedes that "new franchise negotiations may require a year to conduct" even after the filing of a "formal application." *Chicago Comments* at 4.

[61] Verizon generally has to spend substantial time preparing for each individual municipality before it even contacts a particular LFA. *See March 8 Ex Parte* at 2. For example, Verizon must familiarize itself with local ordinances and other applicable regulations, obtain and review the incumbent's franchise agreement, and draft a proposal that is likely to appeal to the individual LFA based on these pre-existing conditions. *Id.* These preliminary steps typically add months to the overall process of obtaining a franchise. *Id.*

[62] *GMTC Comments* at 11.

Of course, there is no legitimate reason for the franchising process to take this long – particularly in the case of a competitive provider who already has authority to deploy the network over which it will provide video services. For example, Verizon has been able to negotiate franchises with several LFAs in 4 months or less, while Texas has determined that it is able to complete the process in 17 days. *See Verizon Opening Comments,* Attachment A, Exh. 1. Indeed, even NATOA's representative recently told the Commission at its open agenda meeting in Keller, Texas, that she believed that the franchising process should take no more than six months.

1. The incumbent cable operators, in turn, point to those few locations where Verizon *has* received a franchise relatively quickly, and then suggest based on these isolated success stories that there is no problem with delay in other places. *See, e.g., Comcast Comments* at 10. But as noted above, they wholly ignore the more typical examples that take far longer and can easily extend to 18-24 months.

Another misleading approach that the incumbents (and some LFAs) take to understate the delay that Verizon has experienced is to focus strictly on the time that it takes for a franchise to be granted *after* the filing of a formal application. For example, Cablevision argues that Verizon has experienced no delays in receiving franchises by misleadingly suggesting that Verizon has sought only cable franchises in three communities in New York and that in each those communities it received a franchise "within 30-35 days of its application." *Cablevision Comments* at 3; *see also Comcast Comments* at 10 (citing the same three communities and noting that "the time interval between *formal* application and LFA approval of the franchise was approximately one month").

In reality, the LFAs at issue required months of negotiation before even permitting Verizon to file a formal application, and additional time was necessary *after* the LFA approved a franchise agreement in order to obtain the requisite confirmation from the New York PSC. So rather than 30-35 days, the franchising process in these three communities took 5 months in one case, and 15 months in the other two, measured from the time that Verizon initiated negotiations until it finally gained permission to offer video service. *See Verizon Opening Comments*, Attachment A, Exh. 1. And Cablevision's claim that Verizon has only sought three franchises in New York is equally wrong. In fact, Verizon is in negotiations with more than 100 LFAs in New York, and nearly two-thirds of these negotiations already have been underway for at least a year, while 28 have been ongoing for 15 months or more.

2. Similarly unavailing are the misleading suggestions by NCTA that the franchising problem has not been a barrier to Verizon's entry into the video market because "[i]n most cases where Verizon has received a franchise, it has not yet begun offering service." *NCTA Comments* at 11; *see also RCN Ex Parte* at 2. NCTA then provides an unremarkable chart showing that it sometimes takes some period of time before Verizon offers video service in some of the communities in which it has obtained a franchise. *NCTA Comments* at 11. These statistics are meaningless. As a new entrant in the video market, of course it takes some time to "go live" in a community after finally gaining permission to enter the market. And given the vagaries and uncertainties of the current franchising process – including the delays often reaching 18-24 months – it is also reasonable for Verizon to wait for a franchise before undertaking those final preparations.

In fact, where the uncertainties caused by the franchising process have been removed, Verizon has been able to offer service quickly after obtaining a franchise. For example, less than

30 days after Texas streamlined its franchising process, Verizon filed an application for a franchise with respect to 21 municipalities in that State. With the barrier of local franchising gone, Verizon was able to launch service in the majority of those municipalities in significantly less than 45 days. This clearly illustrates that, once the barriers created by local franchising are removed, Verizon intends to aggressively bring its competitive video services to market. And Verizon also is providing service in locations in New York, Massachusetts, Florida, Virginia, Maryland, and California as well.

Moreover, as explained more in the next section, the incumbents' arguments in this regard ignore their own role in delaying the deployment of competitive services, even after Verizon or other competitive providers obtain a franchise. Whether during or after the franchising process, the incumbents have demonstrated a willingness to throw up roadblocks to competitive entry at every turn, thus delaying Verizon's and other competitive providers' ability offer video services quickly.

2. Delay Tactics by Incumbents, Often Based on So-Called "Level Playing Field" Requirements, Are a Primary Source of Delay.

In addition to denying the pervasiveness of delay, the incumbents and some LFAs attempt to cast blame for any delay on the new entrant by arguing that such providers could avoid delay by simply accepting identical terms to the incumbent, rather than negotiating a separate deal that makes more sense for a competitive provider. These arguments are without merit.

Many LFAs and incumbents in this proceeding assert that a new entrant supposedly could gain speedy entry if only it would agree to identical terms that were extracted from the incumbent, whether or not such terms are consistent with the Cable Act. For example, a group of Maryland LFAs argues new entrants should accept a "clone of the existing franchise," stating:

"If a competitive franchisee presented a local community with a proposal simply to accept the terms of the existing cable franchise, the deal *might* well be done in less than 120 days." *Montgomery County Comments* at 41 (emphasis added).[63] Not surprisingly, the incumbent cable operators embrace this approach as well.[64] But, as Verizon explained in its opening comments and addresses again below, imposing burdens on a new entrant that go beyond what is permitted by the Act raises the costs of entry without justification, thus making it less likely that the incumbent will face competition in the first place. *See Verizon Opening Comments* at 76-80.[65] As Verizon explained in its opening comments, LFA discretion in granting a competitive

[63] *See also GMTC Comments* at 12 ("Negotiations could have been expedited if the applicant would have agreed to abide by identical terms and conditions as required of the incumbent cable operator."); *Michigan Comments* at 14 (noting that "[o]ne could see how the 120 day timeframe might be a workable 'best practice' deadline where a competitive franchisee presents an LFA with a proposal to meet the terms of the existing franchise" and suggesting that three years would be more appropriate than 120 days where a "competitive franchisee seek[s] a tailored franchise"); *NATOA Comments* at 29 (noting that an incumbent's franchise agreement is the "touchstone" and suggesting new entrants can gain approval quickly "if the new provider were willing to agree to franchise terms comparable to those imposed on the incumbent cable provider"); Comments of New York State Conference of Mayors and Municipal Officials, at 3 (filed Feb. 9, 2006) (noting New York PSC approval of "streamlined process for granting a second franchise to any company that agrees to the same terms and conditions of an existing franchise").

[64] *See Comcast Comments* at 13-14 (noting that franchising process is "simple and straightforward" if new entrant agrees to all the same terms as the incumbent because there is "not much to negotiate about"); *Cablevision Comments* at 3 ("Verizon is entitled to expedited local review of its franchise applications in 30 days if it agrees to abide by the existing franchise."); *NCTA Comments* at 12 ("There is no reason to believe that telephone companies could not obtain franchises in the blink of an eye if they were willing to accept terms and conditions substantially similar to those imposed on existing cable operators in the communities they seek to serve.").

[65] For the same reason, the "streamlined" approach trumpeted by Cablevision and New York State Conference of Mayors provides little benefit to a new entrant. *See Cablevision Comments* at 13; Comments of New York State Conference of Mayors and Municipal Officials, at 3 (filed Feb. 9, 2006) ("*New York Mayors Comments*"). That procedure also would require a new entrant who agrees to abide by all of the same terms as the incumbent's franchise, whether or not they are consistent with the Act. Therefore, the availability of this "streamlined" franchising procedure is illusory.

franchise is strictly limited by Section 621(a), other provisions of the Cable Act, and the First Amendment, and an LFA may not condition the award of a competitive franchise on more than the Cable Act expressly permits it require – even if an incumbent agreed to more in the past as a means of acquiring or maintaining its monopoly position.

Another, related argument that the incumbents and some LFAs make is that Verizon contributes to any delay that it experiences by starting from a "model franchise agreement" when it initiates negotiations with an LFA, or by otherwise acting unreasonably in the course of negotiations.[66] But some level of uniformity in franchise terms is essential for a provider who is entering the market on a wide scale using a national broadband network, in order to take advantage of economies of scale that make competitive entry feasible. *Verizon Opening Comments*, Attachment A, at 19. Nothing in the format of the agreement proposed by Verizon can justify delays in approval of franchise applications.

Moreover, as a number of commenting parties demonstrate, Verizon consistently has engaged with LFAs in a good faith and reasonable manner. For example, Manatee County, Florida states that it "understood the desire for a corporate-wide agreement . . . [and] ultimately

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[66] *See, e.g., Montgomery County Comments* at 41; *GMTC Comments* at 12; *Texas Coalition Comments* at 10-11; *Comcast Comments* at 16; *Cablevision Comments* at 3-4. In a recent *ex parte*, Montgomery County, Maryland provides a summary of its negotiations with Verizon, and also an additional list of "key problem areas. *See* Letter from Gerard Lederer, Counsel for Montgomery County, Maryland, to Marlene Dortch, FCC, MB Docket No. 05-311 (filed March 17, 2006). Each of these documents is incomplete and inaccurate. Unfortunately, Verizon's confidentiality agreement with the County prevents it from rebutting this showing in detail, but the County's documents omit several unreasonable demands pressed by the County. For example, even the County's letter shows that the County believes that it may assert regulatory control over the construction and operation of Verizon's FTTP network, even though that network is being constructed and operated pursuant to Verizon's independent authority under telecommunications laws. *Id.* at attachment 4, p. 2. Also, the County appears to object to a franchise provision that would prevent the County from being able to assess franchise fees on "non-cable services." *Id.* Therefore, this letter provides further evidence of the types of unreasonable and unlawful demands that frustrate competitive entry.

was able to work with Verizon's draft." *Manatee County* at 5. It also acknowledges that Verizon was reasonable in negotiations concerning the County's various "business terms," including such items as PEG carriage and support, and states that "Verizon did not significantly resist the concept of local tailoring of these, and only sought to satisfy itself that the requested levels of support were supported by law and supported by specific information from the County concerning the community's current and future cable-related needs." *Id.* at 6. And it candidly admits that its experience with Verizon "caused [it] to recognize that its then-existing cable ordinance was not in the best shape to effectively and efficiently deal with core issues most important to the County, while also complying with all applicable superior laws." *Id.* at 8.

Fairfax County, Virginia recounts to the Commission a similar experience. It too says that it had some concerns with some of the terms of Verizon's opening proposal, but notes "Verizon-VA's willingness to negotiate changes to those terms." *Fairfax County Comments* at 7. This LFA also praises Verizon for "committ[ing] the negotiation staff and corporate resources to fully engage in the cable franchise negotiation process." *Id.* at 5.[67]

More fundamentally these claims simply miss the point. Regardless of whether the need to negotiate new terms or to revise proposed agreement language contributed some number of days or even a week or two to the delays, the fundamental problem is that lengthy delays are inherent and endemic to the franchising process in its current form. And absent prompt action by this Commission, that will continue to be the case as it has been for decades.

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[67] *See also* Comments of the City of Bowie, Maryland, at 5 (filed Feb. 9, 2006) ("*Bowie Comments*") (noting that Verizon "initially wanted to negotiate using their standard form," but stating that the LFA "ha[d] been able to reach agreement on most of the items and believe[s] that we are close to reaching an agreement"); *GMTC Comments* at 17 (noting that "Verizon negotiated in good faith" on terms important to LFA and reached agreement "in short order").

In contrast to the incumbents' unfounded allegations that Verizon's negotiating practices are the cause for the delays it experiences in the franchising process, there is ample evidence in the record that incumbents prolong the process as a matter of course in order to forestall video competition. For example, Howard County, Maryland says that in its recent negotiations with Verizon, the County was "held hostage by an incumbent that insists that any competitive agreement needs to be identical," and describes the efforts by Comcast to delay the awarding of a competitive franchise:

> [T]he incumbent cable operator, Comcast, made a *concerted effort to delay* approval of the negotiated competitive agreement with Verizon. Comcast aggressively lobbied policy makers and raised level playing field and other issues in an effort to have the agreement tabled. The County believes that the issues raised by the incumbent *were largely inaccurate and inappropriate attempts to stall the process* for the competitive franchise.

GMTC Comments at 14, 16 (emphasis added).

A group of Texas cities confirms this experience, noting that "frequently the incumbent cable provider interjects itself into the process by monitoring the negotiations through open records requests, participating vocally in open meetings, advancing arguments on any 'objectionable' provisions from its perspective . . ., and essentially are demanding to have a place at the negotiating table and 'insisting' that any new franchises be tailored to the incumbent's franchise." *Texas Coalition Comments* at 7-8.[68] This group notes that "[e]ven if every 'party' to the negotiations is reasonable, the cable franchising process can be delayed by such requests of the incumbent," and that "delays in *competitive franchise* negotiations result from the incumbent

[68] *See also Manatee County Comments* at 17 (noting that incumbents in that jurisdiction "expressed exacting concern over Verizon's application" and that "[t]he County's Verizon negotiation files were subject to regular public records requests and the incumbents provided several critiques of the various franchise drafts during the process").

cable provider's demands that competitive providers' franchises contain virtually identical terms." *Id.* at 8, 13.

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The record in this proceeding overwhelmingly demonstrates the need for hard and fast deadlines on the franchising process in order to prevent the process from delaying competitive entry. As Verizon explained in its opening comments, four months – the period of time the statute allows for franchise renewal and transfer decisions[69] – is ample time for LFA action on a competitive franchise application, and adopting a binding four-month deadline for such LFA decisions would give effect to Congress' intent in adopting Section 621(a).[70] In fact, as other parties suggest, even shorter timeframes would be appropriate.[71] And even some LFAs concede that the franchising can be completed in roughly similar timeframes, as when NATOA's representative told the Commission that LFAs should be able to complete the process within six

[69] While these provisions address incumbents who are already offering video service, there is no reason that a longer period of time should be required in the case of a new entrant. As explained above, and in Verizon's opening comments, the statute strictly limits the requirements that an LFA may impose on a new entrant, and provides a very limited set of factors which may be considered in connection with a franchise application. As Verizon's experience has shown, LFAs who limit their franchising decisions to these factors are routinely able to complete the process in much less than four months. In fact, the State of Texas has determined that the process may be completed within 17 days. Also, if anything, the need for expeditious review is greater in the context of a competitive provider seeking entry to the market than in the case of a an incumbent seeking renewal or transfer, because, unlike in those other contexts, the new entrant is prevented from providing service and engaging in protected speech pending the LFA's decision. Finally, the need for protracted review is particularly absent in the case of telcos that offer video service over their broadband networks because they do not need a franchise in order to access public rights-of-way to deploy a network.

[70] *See Verizon Opening Comments* at 35-38; *see also FTTH Council Comments* at 61 (endorsing 4 months as maximum time limit, although expressing preference for much shorter deadline); *C4CC Comments* at 9 (endorsing 4 month deadline).

[71] *See, e.g., FTTH Council Comments* at 61 (noting preference for 17 day limit); *Mercatus Comments* at 2 (suggesting 30 days); *AT&T Comments* at 75 (30 days); *Telecommunications Manufacturers Comments* at 4 (30 days); *BellSouth Comments* at 36-37 (90 days); *South Slope Comments* at 14 (90 days); *NTCA Comments* at 9-12 (90 days).

months. The Commission should effectuate the pro-competitive purposes of Section 621(a) by adopting binding and preemptive rules that would permit a competitor to start offering video services when an LFA fails to act within a specified, reasonable period of time.

B. The Commission Must Prohibit Unreasonable and Anticompetitive Build-Out Requirements.

Verizon explained in its opening comments that unreasonable and anti-competitive build-out requirements – often at the urging of incumbent providers – are another significant barrier to competitive entry. *Verizon Opening Comments* at 39-54.

As an initial matter, the Act does *not* require a new entrant to build out and provide service throughout an LFA's jurisdiction or an incumbent's franchise area, rather than defining its own franchise area. Rather than providing a basis for imposing burdensome or anticompetitive build-out obligations on a competitive provider, the statute's only reference even arguably related to build out – Section 621(a)(4)(A) – imposes an additional *restriction* on LFAs by prohibiting the imposition of unreasonable timeframes on a provider for offering service within its "franchise area." 47 U.S.C. § 541(a)(4)(A). This restriction on LFA discretion cannot be read to undermine Congress' pro-competitive purpose in Section 621(a) by unreasonably burdening competitive entry.

Moreover, the Act is silent on the issue of *who* may determine the boundaries of a competitive provider's franchise area, and nothing in the Act assigns that role to LFAs. Nor does the Act even define what a "franchise area" is, although the text of the Act shows that Congress did not intend to require "franchise areas" that are coterminous with an LFA's jurisdictional boundaries. While Section 621(a)(4)(A) speaks of a "franchise area," other provisions of the Act refer to a local franchising authority's "jurisdiction." *See, e.g.*, 47 U.S.C. § 543(a).

Thus, the Commission can and should fill the statutory gaps in a manner that best effectuates the pro-competitive purpose of Section 621(a) by allowing a competitive provider to define its own, reasonable franchise area, and requiring LFAs to accept any such definition that is reasonable and otherwise consistent with the Act. *See, e.g., Brand X*, -- U.S. --, 125 S.Ct. 2688, 2700 (2005) ("it is for agencies, not courts, to fill statutory gaps").

1. Build-Out Requirements Are an Anticompetitive Barrier to Entry.

The Commission already has recognized, in the context of telecommunications services, the anticompetitive impact of imposing build-out requirements on a competitive provider as a condition of entering the market, and has expressly preempted such requirements to prevent this impact.[72] The Commission correctly noted then that build out requirements are "prohibitively expensive" for a new entrant and this "financial burden . . . has the effect of prohibiting certain entities from providing telecommunications services," and therefore these requirements "impact the threshold question of whether a potential competitor will enter the local exchange market at all." *Id.* ¶¶ 13, 78, 81, 95.

Indeed, in that similar context, the same cable incumbents who now maintain that build-out is necessary for fair competition vehemently opposed, and successfully avoided, build-out or universal service obligation when they began to offer telephone services. For example, in testimony to the Senate in 1994, the president of Comcast stated: "you should not require that every provider must make service available to every household in a state or service region. That is simply unrealistic to expect of new entrants in this market, and it is simply unnecessary." *The Communications Act of 1994: Hearing on S. 1822 Before the Senate Commerce Committee* (May

[72] *The Public Utility Commission of Texas*, 13 FCC Rcd 3460, ¶ 13 (1997); *see also Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, 17 FCC Rcd 4798 (2002).

18, 1994) (statement of Brian Roberts, President, Comcast Corporation on Local Loop Competition and Universal Service Issues). Likewise, in arguing in favor of a rule that permits competitive telephone providers to have a single point of interconnection per LATA rather than building out a network to mirror an incumbent's, Cablevision viewed build-out differently, stating that "the Commission wisely refused to bind CLECs to the legacy network built by the ILECs" and supporting rules that "permitted CLECs the flexibility to take advantage of new technology and to design unique systems, business plans, and service offerings."[73]

These conclusions apply equally in the context of video services. For example, NTCA – "nearly half of [whose] members . . . operate as . . . incumbent" cable operators – agrees that "[b]uild-out requirements only make sense in a monopolistic environment or one in which certain benefits attach to the obligation" and concludes:

> It does not make sense, and is potentially devastating to the business case of new entrants, to force new entrants to adhere to the same build-out obligations as incumbents. The benefit of a franchise award is no longer one of an exclusive right to provide service within an area. New entrants offer service to subscribers competing against a very well established incumbent. The risks are great and success is not at all guaranteed. . . . The services provided by new entrants must be guided by sound business principles. Forcing new entrants to build-out an area before it can be financially justified is tantamount to forcing new entrants out of the video business.

NTCA Comments at 4, 6-7..[74] *See also* Reply Declaration of Thomas Hazlett, attached hereto as Attachment A, ¶ 17 ("*Hazlett Reply Decl.*"). At least some LFAs also concede in this context

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[73] Comments of Cablevision Lightpath, Inc., *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, at 4 (Aug. 21, 2001).

[74] *See also PRI Comments* at 3 (calling build-out "one of the biggest regulatory hurdles for competitors," and noting that this "capital-intensive demand serves to seal monopolistic conditions") ; *Discovery Institute Comments* at 7 ("[c]ompetitive entrants already have an incentive to expand their networks," but that build-out obligations deter entry by "impos[ing] costs that may not be recoverable in a competitive market"); *FreedomWorks Comments* at 18-19 (noting that build-out requirements are inappropriate because "[n]ew entrants make investments

that "you cannot ask a party to make investments that are uneconomical." *Michigan Comments* at 49.[75] Even MMTC – one of the commenters most focused on the issue of redlining – notes that build-out requirements "might in some instances end up being themselves a strong barrier to entry and thus counterproductive." *MMTC Comments* at 23.

Therefore, despite the stance of many LFAs and all incumbents concerning the propriety of imposing build-out requirements on new entrants, there is widespread recognition in the record concerning the potential entry-deterring effects of build-out requirements that would condition market entry on uneconomic investment or deployment. In fact, the record shows that such requirements have had precisely that effect already, as several commenters have documented instances in which build-out requirements have prevented competitive entry.[76]

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with no guaranteed rate of return they do not have a monopoly that ensures they will recoup their costs."); *Consumer Institute Comments* at 7 ("Requiring entrants to build out faster than financially rational adds a new risk for entrants that will raise the cost of capital and slow down the rate of new capital formation."); *BSP Comments* at 4 (noting that build-out requirements "primarily serve to delay or limit the growth of competition by negatively impacting the availability or use of capital"); *Mercatus Comments* at 40; *USIIA Comments* at 9; *C4CC Comments* at 8; *BellSouth Comments* at 30-35; *Qwest Comments* at 8-13; *AT&T Comments* at 43-53; *USTelecom Comments* at 21-36; *Cavalier Comments* at 4-5; *Cincinnati Bell Comments* at 10-11.

[75] *See also Burnsville Comments* at 13 (noting limits on build-out obligations imposed on incumbents and recognizing that "[p]lacing undue economic burdens on cable operators does not serve the public interest"); *Fairfax County Comments* at 8 (recognizing that limitations on build-out requirements imposed on incumbents were intended to make deployment "economically reasonable" and would be *unreasonable* to impose the same requirements on new entrants).

[76] *See, e.g., South Slope Comments* at 8-10 (explaining that build-out requirements demanded by LFAs in its service area have "effectively prohibited [it] from offering video"); *USTelecom Comments* at 22-25 (providing examples several small telcos who were kept out of the video market as a result of build-out requirements); *FTTH Council Comments* at 19-21, 32-36 (examples of build-out requirements preventing competitive entry); *BellSouth Comments* at 35 (describing communities in which build-out demands prevented franchise agreement).

2. Incumbents Push for Build-Out to Avoid Competition Are Disingenuous and Unavailing.

Perhaps the best evidence of the anticompetitive potential of placing build-out requirements on new entrants is the vehemence of the cable incumbents' insistence that build-out should be required. "[F]or an industry to assert that new entrants must have access to their customers before they enter the market raises questions about their ultimate motives" because "[t]ypically, firms protect their customer base and would strive to keep them beyond the reach of their competitors." *FreedomWorks Comments* at 19; *see also Hazlett Reply Decl.* ¶ 5.[77] The incumbents try to distract attention from their transparently anticompetitive efforts in two interrelated ways. Their claims are without merit.

1. First, they argue that new entrants intend to "cream-skim" or "redline" and only serve "high value" areas. The incumbents, together with a handful of other commenters, attempt to smear Verizon and other new entrants with unfounded claims of economic redlining in order to justify unreasonable build-out obligations.[78]

As an initial matter, Verizon has repeatedly stated that it agrees that it and any other new entrants should be subject to the same federal prohibition on redlining that already applies to the cable incumbents. But, as explained above and as the Commission itself recognized in the *Franchise NPRM, id.* ¶ 23, anti-redlining and build-out are not synonymous, contrary to the suggestion of incumbents and some LFAs. In fact, both the Commission and federal courts have

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[77] *BellSouth Comments* at 35 ("This seemingly irrational decision by the incumbent cable operator to force the new entrant to develop additional service scope can only be explained by one fact: the incumbent fully realized the extent to which a build out requirement poses a competitive barrier, which in many instances, the prospective new competitor cannot sustain.").

[78] *See, e.g., Comcast Comments* at 24; *NCTA Comments* at 3-4, 15; *NATOA Comments* at 34; Comments of the Virginia Cable Telecom. Assoc., at 1-3 (filed Feb. 13, 2006) ("*Virginia Cable Comments*"); *Consumers Union Comments* at 4-5.

concluded that the Cable Act's prohibition on economic discrimination does not require universal build-out. While Section 621(a)(3) requires an LFA to ensure that a provider does not deny service to an area because of the income of its residents, both the Commission and the courts have recognized that this does not mean that a provider must provide universal service throughout an LFA's jurisdiction. "The statute on its face prohibits discrimination on the basis of income; it manifestly does not require universal service."[79] Indeed, as the Commission considered rules to implement the 1984 Cable Act, the cable incumbents argued exactly this point, with NCTA/CATA correctly and successfully arguing then that "the intent of [Section 621(a)(3)] is to prevent 'redlining' and does not require wiring of those homes that are too remote to wire economically."[80]

Beyond the legal arguments, however, there is no basis in fact for the redlining charges leveled against Verizon. Essentially, the opponents of reform base these claims on certain out-of-context statements made by other parties concerning "high value customers,"[81] and then point

[79] *ACLU v. FCC*, 823 F.2d 1554, 1580 (D.C. Cir. 1987); *see also Americable International, Inc. v. Department of Navy*, 129 F.3d 1271, 1274-75 (D.C. Cir. 1997) (concluding that Section 621(a) "does not . . . require . . . [build out] "throughout the franchise area"); *Implementation of the Provisions of the Cable Communications Policy Act of 1984*, 58 Rad. Reg. 2d (P&F) 1, ¶ 82 (1985) ("*1984 Cable Act Implementation Order*")(noting that "redlining" prohibition "does not mandate that the franchising authority require the complete wiring of the franchise area in those circumstances where such an exclusion is not based on the income status of the residents in the unwired areas."); *AT&T Comments* at 61-64; *BellSouth Comments* at 30-35; *USTelecom Comments* at 26-27..

[80] *1984 Cable Act Implementation Order* ¶ 82 (noting that "redlining" prohibition "does not mandate that the franchising authority require the complete wiring of the franchise area in those circumstances where such an exclusion is not based on the income status of the residents in the unwired areas.").

[81] Some parties try to attribute certain statements made by AT&T about its plans for its own video deployment to Verizon and other competitive providers more generally. That approach sweeps much too broadly. Verizon is approaching the video market much differently than AT&T, and its business and technological plans differ in important ways. Therefore, any statements by AT&T in this regard have absolutely no relevance to Verizon.

to particular, affluent communities in which Verizon is upgrading to fiber or has obtained franchises. This approach ignores important facts concerning the way that Verizon is upgrading to FTTP, as well as the facts concerning other, less-affluent communities now receiving the benefits of this upgrade.

As Verizon explained in its opening comments, it upgrades to FTTP on a wire-center-by-wire-center basis, generally extending fiber throughout the particular wire center without regard to political or neighborhood boundaries. Therefore, the perception that the incumbents would like to create that Verizon runs fiber only to rich neighborhoods turns a blind eye to reality. On the other hand, requiring Verizon to offer video service to any houses outside of a wire center that has been upgraded to FTTP would pose a substantial barrier to entry – requiring Verizon to upgrade a different wire center (a major undertaking), or go even further and require Verizon to deploy facilities outside of its traditional telephone service area, would create an obvious barrier to entry.

Indeed, Manatee County discusses in its comments the significance of Verizon's method of deployment, and its important differences from traditional cable operators, stating:

> Part of the process of addressing [a negotiated build-out commitment within Manatee County] was the need for County officials to understand the method Verizon is using to construct it system since unlike traditional cable companies which build from "a headend" Verizon is building from each of its several "call centers" within the County. These call centers do not respect jurisdictional lines but are instead driven by technological capacity, natural barriers, and redundancy capability.

Manatee County Comments at 6. After this LFA came to understand this difference, the parties reached agreement on a reasonable level of build-out consistent with Verizon's deployment that "will include passing homes in both well off and lower income neighborhoods." *Id.*

Therefore, the reasonable method that Verizon uses to decide where to offer video services – basing that decision on the homes served by a wire center that has been upgraded to fiber – belies any claims of redlining or cherry-picking, particularly in light of the planned scope of Verizon's FTTP upgrade. Verizon has already passed over three million homes and businesses with FTTP, and plans to double that by the end of 2006 – already covering approximately 20% of the households in its telephone service area. And Verizon has announced its intention to continue passing approximately 3 millions premises per year over the next few years,[82] eventually passing about 18 to 20 million homes and businesses with fiber.[83] Thus, Verizon's business plans clearly do not involve just making its video services available to the chosen few.

The massive scope of Verizon's FTTP deployment also reveals the fallacies of the incumbents' misleading approach of highlighting a selected handful of the affluent communities where Verizon is upgrading to fiber. *See, e.g., Virginia Cable* at 3; *Consumers Union Comments* at 4-5. In doing so, they ignore the fact that many places receiving FTTP are lower-income or otherwise more diverse areas. For example, while focusing on the income level in Fairfax County, Virginia, these parties do not mention that Verizon is also upgrading to fiber in communities like Richmond, Norfolk, and Newport News where the median income is lower than the Commonwealth's average, nor do they mention that over half of the 21 communities in Virginia where Verizon has announced FTTP deployment are more ethnically diverse than the Commonwealth as a whole. Nor do these parties mention places like Passaic, New Jersey;

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[82] Thomson StreetEvents, Conference Call Transcript, *VZ-Verizon at Bear, Stearns & Co. 19th Annual Media Conference*, at 4, 8 (Feb. 27, 2006).

[83] Ivan Seidenberg, Chairman and CEO, Verizon, Keynote Address at the USTA TelecomNEXT '06 (March 20, 2006).

Pomona, California; or Lynn, Massachusetts, each of which has a lower median income level, and is more ethnically diverse, than its respective state, and each of which is receiving, or will soon receive, FTTP. Therefore, the isolated examples that these opponents cite prove nothing.

On the other hand, Verizon's history of providing its other services to individuals of all income levels and backgrounds throughout its service area refutes any suggestion that Verizon intends to redline. *See, e.g., MMTC Comments* at 6 (discussing practices adopted by Verizon-D.C. in the context of other services that make "redlining . . . simply unthinkable"). For example, Verizon currently offers DSL to over 80 percent of the customers in its telephone service area – and over 90 percent in urban areas. As this experience makes clear, Verizon has not and will not engage in economic redlining.

Furthermore, Verizon's FiOS TV offers one of the most diverse programming line-ups in the history of the business. This includes more than 50 ethnic channels that are available to all of our subscribers across our footprint – not just in selected areas.[84] Verizon would not have put together this diverse programming if intended to focus its efforts on a particular, insular group, and the fact that it did so shows that Verizon plans to offer FiOS TV to a broad range of potential customers.

In any event, as the record here also shows and as studies have repeatedly demonstrated, it would be bad business to only target wealthy communities for video services because low-

[84] Verizon is offering subscribers a basic service package @ $12.95/month, an expanded basic package @ $34.95/month, or a Spanish-English package called La Conexion at $32.95/month. La Conexion includes more than 20 of the hottest Spanish-language channels, more than 30 of the most popular English channels, and local channels such as Telemundo, Univision, and Telefutura. Verizon offers an additional all Spanish-language package with more than 20 channels of news, sports, movies, telenovelas, and more for an additional $11.95/month. Our subscribers may also select other individually priced international channels in Vietnamese, Chinese, Mandarin Chinese, Japanese, Korean, Arabic, Italian, French, Polish, Farsi, and Russian.

income communities and other, more diverse communities have equal or greater demand for video services.[85] As MMTC and the other groups with which it has filed comments point out, there is "clear evidence that minority and low-income households disproportionately consume MVPD services," and "[t]he assumption that minorities consume less in the way of communications services than non-minority groups is demonstrably false." *MMTC Comments* at 3, 13. Accordingly, new entrants in the video market have every incentive to make their services widely available. *See BSP Comments* at 6-7 (explaining that redlining makes no business sense for competitive providers).

On the other hand, attempting to force any new entrant to offer competitive video services in an area where it would be uneconomical to do so – whether that area is rich or poor – risks denying *all* parts of a community the benefits from competition that they would otherwise receive. As the TIA notes, rather than accept uneconomical build-out requirements, a new entrant is likely to "shift[] scarce resources to communities that do not have build-out requirements," with the result that a "rule designed to prevent 'economic redlining' *within a community*" could prevent whole communities from receiving competitive video services." *TIA Comments* at 10 (citations and quotations omitted).

2. The second, and equally implausible, argument pressed by incumbents in favor of broad build-out requirements for new entrants is that "if telephone companies are not required, as are existing cable operators, to serve all neighborhoods in a community, residents of lower-

[85] Another recent study also demonstrates that this fact improves the business case for deploying advanced broadband networks in low-income areas, although the imposition of unreasonable build-out requirements that risk making deployment economic could result in less deployment in these areas. *See* George S. Ford, Thomas M. Koutskey and Lawrence J. Spiwak, *The Impact of Video Service Regulation on the Construction of Broadband Networks to Low-Income Households*, Phoenix Center Policy Paper No. 23, at 3 (Sept. 2005).

income neighborhoods will likely be adversely affected . . . [because] disparate regulation would undermine the ability of existing operators to continue to serve customers in those areas that are most costly and least lucrative to serve." *NCTA Comments* at 3-4. This argument is flawed from both a factual and economic perspective.

First, as just explained, the cable incumbents are wrong on the facts when they assume that new entrants like Verizon will "cherry-pick high-income neighborhoods" or that customers in lower-income neighborhoods are less "lucrative" in terms of their consumption of video or other communications services. *See NCTA Comments* at 15-18.

Second, in those communities that have wireline video competition – there is no evidence that *incumbents* have been driven from the market, although there is evidence that plenty of new entrants have. *See Hazlett Reply Decl.* ¶ 9. As explained in more detail in the attached declaration of Thomas Hazlett, NCTA's economic "analysis" concerning the harms of "cream-skimming" is seriously flawed. *Id.* ¶ 4 . As an initial matter, NCTA's analysis assumes, without any evidence, that cross-subsidies in fact exist and that cable incumbents are currently providing service to certain groups of customers at a loss. *Id.*[86] In fact, cable TV systems today sell for about $3800 per subscriber, while costing only about $1200 to construct, which is a reflection of the fact that they are highly profitable and unlikely to be driven out of the market by competitive entry. *Hazlett Reply Decl.* ¶¶ 9-10. Moreover, unlike in the telephone business, cable incumbents have long been able to charge rates that are effectively deregulated, and the cable incumbents have not been required, as a general matter, to provide service to all customers or to

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[86] As the Mercatus Center notes in refuting the cream-skimming argument, "[i]t is by no means clear . . . that cable companies currently sell service to any subscribers at prices that fail to cover incremental costs of serving those subscribers. . . . [and] it is unlikely that cable companies are using profits from lucrative markets to subsidize the prices paid by customers in less profitable markets." *Mercatus Comments* at 41.

any class of customers at below-cost, regulatorily prescribed rates. Instead, their service obligations have always included density and other limitations intended to ensure that deployment would remain economical. Also, cable incumbents remain free to change their rates to cover their costs going forward, and even the minimal rate regulation that applies to the cable incumbents' basic tier and equipment rates would be removed after effective competition exists.

In addition, the import of NCTA's argument, which harkens back to the already rejected natural monopoly justification for exclusive franchises, is that the only way to ensure that all parts of a community have service is to allow the cable incumbent to receive monopoly profits, and any threats to those monopoly profits undermine the viability of offering service throughout the cable incumbent's service area or otherwise complying with legitimate local interests. *Id.* But, as Professor Hazlett explains, discouraging new entry into video in the name of universal service would be a tremendously inefficient policy – particularly given the evidence that competition actually drives cable incumbents to expand or upgrade their networks and services to compete for customers when faced with competition. *Id.* Indeed, Congress has already settled this debate by opting for video competition instead of trusting consumer welfare to the cable monopolists.

3. Finally, as Verizon explained in its opening comments and as cable incumbents know full well, the result of imposing build-out on a new entrant who will face ubiquitous competition from an entrenched competitor is to burden and deter competitive entry. In fact, this recognition on the part of the incumbents is the *only* plausible explanation for their push to face competition with respect to a greater, not lesser, portion of their customer base. And in "calling for an equal footprint," all incumbents really seek is "to raise the costs of potential rivals rather than . . . [protect] consumer welfare." *FreedomWorks Comments* at 19; *see also Hazlett Reply Decl.* ¶ 14.

Consistent with its previous conclusion on this issue, the Commission should recognize that consumers benefit from the introduction of competition, even when competitive providers compete in only a portion of a community,[87] and that "total consumer welfare for [the] community improves [under such circumstances] . . . because no consumer in the community was made worse off and some were made better by competition." *Consumer Institute* at 7; *Mercatus Comments* at 40 (demanding uneconomic build-out inappropriately "precludes subscribers in the potentially competitive areas from enjoying lower rates).

* * *

The record in this proceeding demonstrates the significant barrier to entry posed by build-out requirements, and their lack of justification as applied to new entrants. Many commenters urge the Commission to preempt altogether the imposition of build-out requirements on new entrants,[88] and doing so would most effectively remove a major impediment to competitive entry. At a minimum, the Commission at least should recognize that new entrants are permitted to define their own reasonable franchise area in which they will provide service. *See Verizon Opening Comments* at 42-46; *see also FTTC Council* at 64-65. For example, the Commission should recognize that it is per se reasonable for a provider to define its franchise area by reference to a wire center that it is upgrading to fiber, given the reasonable and non-discriminatory nature of that approach. And, as even some LFAs concede,[89] the Commission should require LFAs to take into account all relevant differences between a new entrant and the

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[87] *Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service*, 67 Rad. Reg. 2d (P&F) 1771, ¶ 134 (1990).

[88] *See, e.g., AT&T Comments* at 61; *BellSouth Comments* at 30-35; *Qwest Comments* at 24-25; *USTelecom Comments* at 21.

[89] *See, e.g., Fairfax County Comments* at 8 (agreeing that differences between incumbents and competitors must be taken into account with build out).

incumbent – including the different competitive situation facing a new entrant as compared to the incumbent and relevant differences in network architecture. *See Verizon Opening Comments* at 51-54. In contrast, any attempts by LFAs to impose nominally identical build-out obligations on new entrants should be deemed per se unreasonable.

C. Demands for Fees or Concessions Beyond Those Permitted by the Cable Act Unreasonably Burden Competitive Entry and Are Preempted.

In its opening comments, Verizon informed the Commission of several types of frequently encountered demands that it receives in the course of franchise negotiations, each of which violates Section 621(a), and many of which separately violate the other express terms of the Cable Act, including the Act's franchise fee and PEG provisions. *See Verizon Opening Comments* at 54-80. NATOA concedes that "LFAs may not impose non-cable-related requirements in franchises," but the record here leaves little doubt that many LFAs attempt to do just that. *NATOA Comments* at 28. And while some LFAs and incumbents try to minimize the prevalence of these illegitimate demands or to justify certain types of demands, their claims are misplaced.

1. Impermissible Franchise Fees.

As Verizon explained in its opening comments, Section 622 of the Cable Act broadly defines the term "franchise fee," and then places an explicit cap on the fees that LFAs may require any cable operator to pay. *Verizon Opening Comments* at 54-64. That section defines "franchise fee" broadly to include "any tax, fee, or assessment *of any kind* imposed by a franchising authority . . . on a cable operator . . . because of [its] status as such," subject to certain, specific exceptions (discussed below, where relevant). 47 U.S.C. § 542(g)(1) (emphasis added). By using such expansive language ("of any kind"), Congress intended for the franchise fee definition to cover any exaction of value – whether monetary or in-kind – except as expressly excluded by Section 622's enumerated exceptions.

The franchise fee definition captures several types of demands that Verizon frequently encounters – ranging from funding for pet projects, to application or acceptance fees, to attorneys fees – and none of these demands falls within the exceptions to the franchise fee definition. Thus, except to the extent these demands are treated as franchise fees and fit within the annual five percent cap, they are impermissible.

No party provides a plausible alternative reading of the statute in this regard. Moreover, other competitive providers confirm that they encounter such demands unrelated to the provision of video services,[90] and some LFAs and incumbents agree that LFAs make the types of demands listed above. For example, Manatee County, Florida states: "In this regard, by its staff's own personal observation, [it] will readily concede that there can be some communities who still try to view cable franchising as a means to extract improper concessions." *Manatee County Comments* at 19. Another LFA admits that it previously required an "arbitrary figure of $50,000" as a "franchise filing fee," though it stated in its comments that it had decided to reduce the fee and move to a "cost-based system." *Indianapolis Comments* at 8.[91] And in a break with

[90] *See, e.g., BSP Comments* at 8.

[91] In a recent *ex parte*, Montgomery County, Maryland challenges certain statements attributed to Verizon concerning the fees that the county would require of Verizon as a condition of receiving a franchise. *See* Letter from Gerard Lederer, Counsel for Montgomery County, Maryland, to Commissioner Jonathan Adelstein, FCC, MB Docket No. 05-311 (filed March 21, 2006). Montgomery County disputes that it would charge $600,000 or more to cover the County's alleged costs associated with granting a franchise, and lists some recent costs assessed of other cable operators providing service within the County. That letter neglects to mention, however, that it negotiates on behalf of separate "participating municipalities" within the County, and requires separate fees on behalf of each of these municipalities. The most recent franchise with the incumbent provider in the County reveals that even back in 1998, the operator had to agree to reimburse the County for costs of up to $200,000 plus up to an additional $25,000 for each of the municipalities covered by the franchise– 19 of which are listed in the agreement. *See* Cable

its brethren, even one cable incumbent expresses frustration with the types of concessions demanded of it during franchise transfer proceedings, noting that it had "faced the same demands ILECs identify." *Charter Comments* at 5-6.

Other LFAs seem to deny that such demands are a problem, and are seemingly oblivious to the toll of these demands on competitive entry. For example, one group of LFAs candidly concedes that its view of a "successful negotiation . . . ends with a franchise agreement in hand that does not leave any money on the table."[92]

The Commission should confirm that these types of demands are contrary to the express terms of Section 622, and should recognize that conditioning a competitive franchise on these impermissible fees – or making demands to that effect that delay the franchising process – is per se unreasonable in violation of Section 621(a).

2. Impermissible PEG and I-Net Demands.

As Verizon explained in its opening comments, the Act places limits on the PEG and I-Net obligations that may be required of a cable operator as a condition of obtaining a franchise, and demands by LFAs that exceed those limits are preempted. *See Verizon Opening Comments* at 64-75.

Franchise Agreement between Montgomery County, Maryland, and SBC Media Ventures, L.P., § 2(h)(5) (June 10, 1998), available at http://www.montgomerycountymd.gov/mcgtmpl.asp?url=/content/ cableOffice/June98franchise.asp. Montgomery County's letter indicates that the "data [are] not available – documents archived" for this franchise. But even for Starpower's limited franchise entered into in 1999 and Comcast's franchise transfer in 2000, Montgomery County admits that it received over $150,000 in costs from the cable operators (presumably not counting the "participating municipalities").

[92] Reply Comments of Southeast Michigan Municipalities, at 50 n.49 (filed Feb. 28, 2006) ("*Southeast Michigan Comments*").

1. As noted before, Sections 611, 621, and 622 set out the limits on what the Cable Act permits an LFA to require from a cable operator in connection with PEG. First, Section 611 states that PEG requirements are only permitted "to the extent provided in [that] section," and then indicates that the only thing an LFA may "require as part of a franchise" is that reasonable "channel capacity be designated for [PEG]." 47 U.S.C. § 531(a), (b). Second, while an LFA may not *require* more, the statute recognizes that LFAs may enforce additional PEG obligations – including for services, fees or equipment – but only when those obligations are "proposed by the cable operator." *Id.* Section 531(c). Third, Section 621(a)(4) permits an LFA to require, as a condition of granting a franchise, "adequate assurance" from a cable operator that it will provide the reasonable channel capacity as well as any other PEG support that the operator volunteers, but limits all such PEG channel capacity (or other PEG support that is volunteered) to a level that is "adequate." *Id.* Section 541(a)(4)(B). Finally, Section 622 indicates that any PEG support counts as franchise fees and is subject to the annual cap on those fees, with the limited exception of "capital costs . . . to be incurred" on a going-forward basis for reasonable and "adequate" PEG access facilities that the provider volunteers pursuant to Section 611(c). *Id.* Section 542(g)(2)(C).

The record in this proceeding – including the comments of some LFAs – confirms that LFAs often demand PEG "support" that exceeds these statutory limits. For example, contrary to the Act's limitation, NATOA argues for an expansive view of the PEG support that LFAs may *require*, noting that "PEG . . . facilities and equipment requirements come in many forms – sometimes they are in-kind, sometimes they are monetary, and sometimes they are a mix of both." *NATOA Comments* at 34. Similarly, NATOA argues that permissible monetary PEG extractions "also vary; they can be in lump sum form, in periodic lump sum payments form, some sort of variable cost form (typically per-subscriber or a percentage of gross revenues), or some combination of both." *Id.* As explained above, the Act does not permit LFAs to impose requirements, but instead permits LFAs to require only the carriage of a reasonable number of PEG channels.[93] Any other PEG support is only permitted if "proposed by the cable operator" and must count towards franchise fees, with the exception of a provider's share of reasonable, going-forward capital costs that it volunteers to provide.

Moreover, even when a provider volunteers to provide PEG support beyond channel capacity, the Act does not entitle an LFA to double dip just because a new entrant comes to town.[94] Rather than "duplicate or gold-plated PEG facilities,"[95] the Cable Act limits PEG support to a level that is reasonable and "adequate." *See* 47 U.S.C. § 541(a)(4). This means that where multiple providers are in a community and agree to provide PEG support, any legitimate and reasonable PEG expenses that they agree to pay should be shared by all such providers – LFAs do not get double. *FTTH Council Comments* at 66. Moreover, any support that such providers volunteer is limited to legitimate PEG capital costs "to be incurred," and not to compensate the LFA again for PEG facilities or support provided in the past. *See id.* Section 542(g). In fact, some LFAs have confirmed that competitive providers should not be

[93] Even in connection with PEG channel capacity, incumbent cable operators frequently try to increase the costs of competitive providers. For example, in several communities where Verizon has obtained a franchise, the cable incumbents have been unwilling to interconnect with Verizon for purposes of handing off the PEG channels that it is required to carry (sometimes even in the face of a state law requiring PEG interconnection). As Verizon explained in its opening comments, this is a blatantly anticompetitive attempt to increase, without justification, the costs of a competitive provider by forcing them to construct redundant and unnecessary PEG facilities. *See Verizon Opening Comments* at 66.

[94] *See, e.g., FTTH Council Comments* at 66-67; *AT&T Comments* at 68.

[95] *AT&T Comments* at 68.

required to fund duplicative or unnecessary facilities. *See, e.g., Indianapolis Comments* at 8; *Chicago Comments* at 4; *see also FTTH Council Comments* at 66.

Thus, the Commission should enforce the Act's express limitations on PEG and preempt any demands in excess of these limitations. Moreover, the Commission should confirm that it would be per se unreasonable to refuse to award a competitive franchise based on PEG demands that exceed what the Act permits an LFA to require.

2. Verizon previously explained that it also frequently encounters demands, characterized as I-Net demands, that exceed the authority assigned to LFAs – often in the form of demands for broadband facilities or services. *See Verizon Opening Comments* at 72-75. Many of these demands are contrary to the express terms of the Act, either because they seek to require Verizon to build I-Net facilities – something the Commission and courts have recognized the Act does not permit – or because they relate to services or facilities that are not I-Nets at all, as that term is defined in Section 611.

The record in this proceeding confirms the prevalence of these demands. The comments of numerous LFAs reflect their claim that an LFA may require the construction of an I-Net as a condition of granting a franchise.[96] As the Commission and the Fifth Circuit have previously held, however, LFAs have no such authority under the Act. *See, e.g., City of Dallas*, 165 F.3d at 350 ("§ 611 does not permit localities to require cable operators to build institutional networks, but instead, by its terms, merely states that" an LFA may require channel capacity on an existing network that qualifies as an I-Net).[97]

[96] *See, e.g., Burnsville Comments* at 10 ("[T]he LFAs may require the construction of an institutional network and may mandate that capacity on the institutional network be designated for governmental and educational use."); *Montgomery County Comments* at 33.

[97] Some commenters also question the need for such facilities in the first place. *See Mercatus Comments* at 35 n. 131 (noting that one authority has "reported that institutional networks go

Moreover, the in-kind services typically sought by LFAs – such as broadband Internet access services – do not qualify under the Act's I-Net definition anyway. They are not "channel capacity" and are not provided over a "communications network . . . generally available only to subscribers who are not residential subscribers." 47 U.S.C. § 531(f). The Commission should confirm that these demands are contrary to the express terms of the Cable Act, and any demand that a new entrant provide such facilities or services as a condition of obtaining a video franchise should be deemed per se unreasonable.

D. The Commission Should Preempt So-Called "Level Playing Field" Requirements That Would Impose Requirements Inconsistent with the Cable Act.

The record here also confirms that the so-called "level playing field" requirements that many incumbent cable operators have convinced various jurisdictions to adopt pose another significant impediment to competitive entry. As discussed above, these protectionist requirements are often cited as a basis for imposing all manner of additional costs and obligations on a would-be new entrant into the market, and incumbents routinely use these requirements as a weapon to interfere with and slow down the franchising process. The simple fact is that regardless of what incumbents may have voluntarily agreed to, LFAs cannot impose requirements on a competitive provider that go beyond those permitted by the Act – and to the extent that state or local law or requirements would do so, they are preempted by the federal statute. *See* 47 U.S.C. § 556.

As an initial matter, these monopolist protection provisions cannot change the nature of an otherwise impermissible demand or expand the permissible scope of LFA discretion in

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largely unused"); *Policy Innovation Comments* at 3 ("city and county buildings all over the nation are full of 'dark' fiber and unused (and unneeded) circuitry that cable companies were compelled to install in those buildings").

considering a competitive franchise application. The Cable Act and the First Amendment both place strict limits on what an LFA may *require* as a condition of granting a competitive franchise, even though the Act contemplates that an applicant for a cable franchise may in some cases offer additional concessions.[98] *See, e.g.*, 47 U.S.C. § 531(a)-(c) (recognizing distinction between PEG obligations an LFA can require and those it can enforce if "proposed by the cable operator"). The narrow discretion that Congress permits for LFAs in considering competitive franchise applications is not increased as a result of any such obligations voluntarily assumed by the incumbent in a monopoly environment, and "level playing field" requirements do not provide a basis for importing those costs or obligations onto a new entrant in a competitive market.

Also, despite the "like services alike" and "fairness" rhetoric of the incumbents, the record here proves that the principle effect of – and indeed the incumbents' only underlying purpose for supporting – these requirements is to deter competitive entry by increasing substantially the costs of new entrants. "[T]hese laws have no other effect than to protect incumbents from competition." *Mercatus Comments* at 39.[99]

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[98] Prior to the 1992 Cable Competition Act, incumbents often had an incentive to volunteer such additional concessions if that helped to secure an exclusive or *de facto* exclusive franchise. For example, whereas federal law strictly limits local authority to demand free or discounted service, payments to support PEG programming, and construction of networks for the special use of the locality, cable operators in the monopoly era frequently offered up such perquisites as an inducement to the award of a lucrative exclusive franchise. The cable operator that succeeded in winning an exclusive franchise could then exploit its monopoly position to recover the costs of these inducements. In more recent years, incumbent cable operators have continued to volunteer such benefits to preserve their de facto monopoly. Indeed, by negotiating franchise terms that threaten the locality with the loss of these benefits if they are not also imposed on an entrant, incumbents have managed to use their agreement to provide such benefits to erect a barrier to competitive entry.

[99] *See also PRI Comments* at 3 ("These 'fairness' measures have in effect served as market entry barriers for rival [providers], which would not be likely to match the financial strength and resources of incumbents."); *FreedomWorks Comments* at 17-18 ("While these laws purported to establish regulatory symmetry and promote the public interest, the ultimate effect was to limit competition to the detriment of consumers.").

As Verizon explained earlier, and numerous other commenters in this proceeding confirm, the ostensibly equal burdens required under these laws in fact impose a much heavier burden on new entrants than on incumbents and thus effect a "*de facto* franchise refusal." *Mercatus Comments* at 39. In exchange for the costs they incurred to enter the market, the incumbents generally received exclusive franchises and enjoyed all of the benefits of being monopoly providers for years, and often decades.

In contrast, a competitive video provider who enters the market today is in a fundamentally different situation, facing ubiquitous competition from strong and entrenched competitors, which in turn leads to lower market share and lower profit margins. Thus, "while a second cable operator will have to make the same unrecoverable investment previously made by the incumbent [if these requirements are enforced as incumbents demand], it will not have the benefit of a monopoly over which to amortize it." *Mercatus Comments* at 40.[100] Also, unlike the incumbents who were able to pay for any of the concessions that they grant an LFA out of the supra-competitive revenue from their on-going operations , new entrants have no assured market position.

Moreover, incumbents' over-eagerness to support these anticompetitive requirements further evidences the need for the Commission to remove this roadblock to competition. As discussed above, several LFAs express frustration at being "held hostage" by incumbents who aggressively assert "level playing field" claims in an effort to frustrate negotiations with competitive providers by arguing that "any competitive agreement needs to be identical to

[100] *See also FTTH Council Comments* at 3 ("New entrants are highly unlikely to ever obtain and enjoy the fruits of market power. Consequently, the burdens of the pre-existing franchising process from the perspective of these new entrants are not offset by the benefits that the monopolists enjoyed.").

constitute a level playing field." *GMTC Comments* at 14; *see also Texas Coalition* at 7-8, 13 ("Most delays in *competitive franchise* negotiations result from the incumbent cable provider's demands that competitive providers' franchises contain virtually identical terms."). And commenters provide the Commission with ample evidence that these requirements have on numerous occasions resulted in the incumbents' desired effect, delaying and preventing competitive entry.[101] For example, in a recent *ex parte*, the BSP Association recounted how the incumbent provider used such requirements to prevent Knology's entry into the Louisville, Kentucky area.[102] Through litigation, the incumbent managed to delay long enough – during which time it upgraded its operations there and further entrenched itself by entering exclusive access arrangements with MDU owners—and make entry expensive enough, that it was no longer feasible for Knology to bring competition to that community.

Moreover, even with respect to the requirements that are permitted by the Act, these so-called "level playing field" requirements can create an impermissible barrier to entry if they fail to take into account all relevant differences between providers, including but not limited to differences in their competitive position in the market and their overall regulatory burdens. Some LFAs suggest that their "level playing field" requirements are sufficiently flexible to permit just that. *See, e.g., Burnsville Comments* at 42 (conceding that some of these requirements may be anticompetitive, but noting that "level playing field provisions that provide [LFAs] with flexibility to tailor franchise terms to existing circumstances, consistent with state and federal law, are not inherently anti-competitive"). And the decision by one federal magistrate judge that several LFAs cite to support the permissibility of these requirements

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[101] *See, e.g., FTTH Council Comments* at 30-31.

[102] Letter from John Goodman, Broadband Service Providers Association, to Marlene Dortch, FCC, MB Docket No. 05-311 (filed March 3, 2006).

expressly relied upon the existence of such flexibility in doing so. *See Cable TV Fund 14-A, Ltd. v. Naperville*, 1997 U.S. Dist. LEXIS 7336, at * 11 (May 27, 1997) ("[T[he Cable Act is not in conflict with the Illinois Overbuild Statute because the Overbuild Act does not require a new franchise to contain terms identical to those in the existing franchise.").

Therefore, the Commission should confirm that the Act preempts any requirements that would impose requirements beyond those permitted by the Act. Furthermore, the Commission should conclude that section 621(a)(1) requires LFAs to take all relevant facts and circumstances of different providers into account when applying these requirements.

E. <u>Verizon Has Authority to Deploy Its Broadband Network in the Public Rights-of-Way Without a Cable Franchise, and LFAs May Not Regulate the Construction or Operation of that Network under the Cable Franchising Powers.</u>

In addition to the problems Verizon has experienced in the process of *obtaining* a video franchise, Verizon described in is opening comments that some LFAs have threatened to exercise a degree of regulatory authority *after a franchise has been granted* that would undermine the federal policy objectives concerning video competition and broadband deployment. *See Verizon Opening Comments* at 80-88. In particular, some LFAs and cable companies have said that once Verizon begins to offer video over its FTTP network, the entirety of the network should be regulated as a "cable system" for all purposes.[103] According to these parties, the addition of video to the network gives broad new authority to municipalities over the entire physical network, including authority to regulate aspects of the construction, operation or placement of

[103] In a recent *ex parte* filed by Montgomery County, it provides a list of "key problem areas" in its negotiations with Verizon. Among the issues included on this list is Montgomery County's objection to being denied regulatory authority over the "construction, installation, maintenance and operation" of Verizon's FTTP network pursuant to the County's Title VI cable franchising authority." Letter from Gerard Lederer to Marlene Dortch, at attachment 4 (filed March 17, 2006).

these networks. And they have suggested that this is so even though the commenters all concede the mixed-use network also delivers voice and data services, and that Verizon has authority to upgrade to FTTP under telecommunications laws, completely independent of a cable franchise.[104]

Before these claims become more of a deterrent to deployment than they already are, the Commission should confirm that this expansive view of municipal authority and of the "cable system" definition is contrary to Section 621(a) and several other provisions of federal law. The Act expressly provides that a common carrier's network that is subject in whole or in part to federal Title II regulation – such as Verizon's FTTP network – is a cable system only "*to the extent*" it is used to transmit video programming directly to subscribers. 47 U.S.C. § 522(7)(C) (emphasis added). This language makes it clear that the entirety of a telecommunications/data network is not automatically converted to a "cable system" once subscribers start receiving video programming. If Congress had intended an automatic and total conversion, it would have said that a common carrier's network becomes a cable system "if" or "whenever" it is used to offer video programming, not "to the extent" that it is so used.

F. Other Issues Unreasonably Burdening Competitive Entry.

In addition to the issues Verizon raised in its opening comments that impact competitive entry into the video market, other parties raised a few additional issues impacting competitive entry that deserve the Commission's attention.

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[104] *See, e.g., Manatee County Comments* at 5; *Burnsville Comments* at 23; *West Palm Beach Comments* at 15; *Lake Worth Comments* at 11; *Comcast Comments* at 34.

1. Rate Regulation of New Entrants.

In its comments, NCTA concedes that in some respects, Congress expressly provided for lesser regulatory burdens on new entrants. NCTA provides as an example Congress' decision to exempt new entrants from economic regulation, stating that "[r]ate regulation, uniform pricing, 'buy-through' restrictions and other provisions in Section 623 of the Act do not apply to new entrants, including telephone companies, because those competitors face 'effective competition' from the existing cable operators as soon as they enter the marketplace." *NCTA Comments* at 13.

Some LFAs nonetheless have expressed an intent to regulate Verizon's rates unless Verizon first goes through the process of petitioning the Commission on a community-by-community basis for a determination that it is subject to effective competition and exempt from rate regulation. *See, e.g., Petition of Verizon New York Inc. for a Certificate of Confirmation for its Franchise with the Village of South Nyack, Rockland County*, New York Public Service Commission, Case 05-V-1571, at 9 (Feb. 8, 2006) ("Although the Village and Verizon agree that the franchisee is subject to effective competition and, therefore, not subject to Commission rate regulation, Verizon must seek such a ruling from the Federal Communications Commission (FCC). Until it has received an exemption from rate regulation from the FCC, rates are subject to federal regulation."). Likewise, in New Jersey, not only are new entrants potentially subject to rate regulation, but they could even be required to file a tariff for competitive cable services. *See,* N.J. Admin. Code §§ 14:18-3.3, 14:18-3.4, 14:18-7.3 (2004). But this has matters exactly backwards.

The Commission's rules require an LFA to obtain certification from the Commission *before* regulating a particular provider's rates, and make clear that such a certification is not available where the LFA "has actual knowledge" that the provider is subject to effective competition. 47 C.F.R. § 76.910. The Commission should confirm this interpretation and prohibit LFAs from regulating the rates of a new entrant.

2. Incumbents' Exclusive Access Arrangements Are Anticompetitive.

The Commission also should prohibit exclusive access arrangements between cable incumbents and MDU owners or developers. In its comments, Manatee County, Florida expresses a concern regarding the anticompetitive effects of increasingly prevalent exclusive access arrangements entered into by cable incumbents that effectively deny residents of the benefits of competition, while also foreclosing a portion of the market from new entrants. *See Manatee County Comments* at 10-11. The County urges the Commission to revisit the permissibility of exclusive access arrangements. *Id.*

Manatee County is correct that exclusive access arrangements between incumbents and real estate developers or MDU owners are a major barrier to competitive entry that the Commission should address.[105] The Commission has previously recognized the anticompetitive potential of such arrangements, but concluded that the record at the time included insufficient evidence to support a prohibition on such arrangements.[106] Therefore, Commission precedent currently permits cable incumbents to reach exclusive access agreements with MDU owners and other developers that would lock-in all of the residents, foreclosing of competitive entry. The

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[105] By contrast, exclusive or preferential marketing arrangements differ both conceptually and from a policy perspective from exclusive access arrangements, because they do not restrict the consumer's available choice of providers. Exclusive marketing arrangements facilitate the sharing of information with consumers by creating an active role for MDU owners in distributing information about a provider's services. Such information allows subscribers to better understand the available services and select between available providers, but without dictating who the provider will be. As a result, it would harm competition – and violate the First Amendment – to restrict marketing arrangements between video providers and MDU owners.

[106] *Telecommunications Services Inside Wiring; Customer Premises Equipment; Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 18 FCC Rcd 1342, ¶¶ 71, 77 (2003).

Commission should reconsider this ill-advised policy and recognize that the exclusive access arrangements entered into by cable incumbents are anticompetitive.

The Commission has previously recognized the anticompetitive potential of exclusive access agreements, concluding for telecommunications services that such arrangements were impermissible in the context of commercial MDUs.[107] In that proceeding, the Commission concluded that exclusive access contracts were an anticompetitive vertical restraint that "pose[] a risk of limiting the choices of tenants in [MDUs] in purchasing telecommunications services, and of increasing the prices paid by tenants." *Id.* ¶¶ 27, 28. Moreover, for an incumbent, "an exclusive [access] contract may essentially constitute a device to preserve existing market power." *Id.* ¶ 29.

Verizon has consistently argued – both in the context of video and telecommunications services – that exclusive access arrangements are anticompetitive and should not be permitted. Exclusive access arrangements reduce or eliminate tenants' ability to obtain services offered by their choice of service providers.[108] The incumbent cable companies should not be permitted to deprive residents of the benefits of competition, whether for telecommunications or for video.

In order to both lower the barriers to entry for competitive video service providers, and to extend the benefits of that competition to all consumers, the Commission should revisit its policies on exclusive access arrangements in the context of MDUs or other real estate developments, and should prohibit the cable incumbents from entering such arrangements.

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[107] *Promotion of Competitive Networks in Local Telecommunications Markets*, 15 FCC Rcd 22983, ¶ 27 (2000). In that order, the Commission decided that it lacked sufficient record evidence to decide whether exclusive access agreements were permissible in residential MDUs, and issued a further notice on that issue. *Id.* ¶¶ 33, 161.

[108] *See, e.g.*, Reply Comments of Verizon, *Promotion of Competitive Markets in Local Telecommunications Markets*, WT Docket No. 99-217, at 4 (filed Feb. 21, 2001).

3. Denial of Reasonable Access to Programming Harms Competition.

Finally, RCN states in its comments that obtaining access to programming, including important and unique programming like regional sports networks, is a significant barrier to competitive entry. *RCN Comments* at 7-8. That is correct.

In its opening comments, Verizon described some of the difficulty it has encountered in negotiating for certain content that is controlled by vertically integrated cable incumbents like Cablevision. *See Verizon Opening Comments* at 28-29, Attachment A ¶¶ 65-74. This conduct ranges from outright refusals to deal for valuable programming to offering unreasonable and anticompetitive terms that effectively deny access to programming. *See id.* Moreover, as Verizon has explained in the past, the so-called "terrestrial loophole" leaves a gap in existing rules that allows incumbents to deny access to regional sports networks or other unique and desirable programming.

The Commission should take steps to address this important issue. Among other things, the Commission can and should immediately close the "terrestrial loophole." *See* Comments of Verizon, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 05-255 at 29-34 (filed Sept. 19, 2005). Contrary to RCN's suggestion, however, these steps should be taken in addition to, not instead of, addressing the many problem areas of the current franchising process.

CONCLUSION

Consistent with Verizon's opening comments and these reply comments, the Commission should address and prevent those practices that amount to an unreasonable refusal to award a competitive franchise, as required by Section 621(a) and other provisions of the Cable Act. The Commission also should preempt LFAs from exercising regulatory control over the construction, placement, and operation of a mixed-use broadband network constructed pursuant to the federal and state telecommunications laws. And it should take steps to address other anticompetitive practices engaged in by the cable incumbents in an effort to delay or prevent competitive entry.

Respectfully submitted,

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March 28, 2006

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:	)	
	)	
Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as Amended by the Cable Television Consumer Protection and Competition Act of 1992	))))	MB Docket No. 05-311
	))))	

DECLARATION OF THOMAS W. HAZLETT

I. INTRODUCTION

1. I submitted a declaration in this proceeding on February 13, 2006.[1] In that declaration, I concluded that numerous practices associated with the existing cable franchising process unreasonably impose substantial barriers to entry. These obstacles help thwart greater competition in the provision of multi-channel video service. By denying consumers the benefits of additional rivalry, these franchising practices impose significant social costs.

2. In Comments received on February 13, 2006, a paper authored by Michael G. Baumann entitled, "The Adverse Effects of Asymmetric Build-Out Requirements in

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[1] Thomas W. Hazlett, *Declaration of Thomas W. Hazlett*, submitted to the Federal Communications Commission by Verizon, *In the Matter of Implementation of Section 621(a) of the Cable Communications Policy Act of 1984 as Amended by the Cable Television Consumer Protection and Competition Act of 1992, Comments of Verizon on Video Franchising,* MB Docket No. 05-311 (Feb. 13, 2006) ["Verizon Comments"].

Cable Television,"[2] was submitted by the National Cable & Telecommunications Association[3] in support of their argument that new video entrants should be subject to nominally identical franchise requirements as those imposed on incumbent operators. In this Reply, I address the issues raised in that paper.

3. Mr. Baumann's paper is correctly captioned – it does not consider the *total effects* of "Asymmetric Build-Out Requirements," but only those which the author sees as "Adverse Effects." The result is a truncated analysis, which does not evaluate both costs and benefits of competitive entry. This "adverse" analysis asserts that broad social goals require that costly franchise burdens be imposed on entrants on the theory that a subgroup of consumers could potentially face higher prices, diminished service, or no service at all. Whatever possible "adverse" consequences are contemplated cannot by themselves justify a given franchising policy because the potential benefits of competition are ignored. Hence, the paper fails to state an economic case for imposing build-out requirements on competitive video entrants.

4. The paper leaves no doubt that the current franchising scheme protects monopoly profits of incumbent operators. This is the only economic interpretation available for two key assertions made. The first is that cable incumbents anticipate that entrants will

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[2] This paper was originally filed last year. See National Cable & Telecommunications Association, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Comments of National Cable & Telecommunications Association,* MB Docket No. 05-255 (Sept. 19, 2005), Appendix A.

[3] Michael G. Baumann, "The Adverse Effects of Asymmetric Build-Out Requirements in Cable Television," ECONOMISTS INCORPORATED (Sept. 14, 2005), Attachment B of National Cable & Telecommunications Association, *In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992, Comments of National Cable & Telecommunications Association,* MB Docket No. 05-311 (Feb. 13, 2006) ["Baumann"].

"cream skim" the profitable parts of their markets if allowed to do so. As Alfred Kahn elucidated in his classic treatise, THE ECONOMICS OF REGULATION, "cream skimming" is another term for *competition*.[4] The evidence is that, overall, cable TV systems are highly profitable and a reduction in profits as a result of competitive entry need not result in a reduction in areas with service.[5] The second is that, were cable TV operators to face rivals not constrained by "universal service" requirements, they would be less willing to engage in subsidies, pay franchise fees or provide any number of other benefits to local franchising authorities. Again, this is exactly the outcome expected when market rivalry produces a more competitive outcome: consumers benefit and suppliers capture fewer profits.

5. Cable TV incumbents advocate "universal service" obligations for video market entrants, and in doing so reveal their true motives. These operators would not advocate such a policy were it to actually prompt wider, more far-reaching build-outs by entrants because the result would be diminished market share and a loss of profits for them. But incumbents know that such obligations reduce the probability that competition will materialize at all, thus making the policy of universal service for entrants a profitable strategy for incumbents. By revealed preference, it is clear that consumers will lose from franchise barriers imposed on new cable competitors.

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[4] Alfred E. Kahn, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS (The MIT Press 1988) ["Kahn"], pp. 220-250.

[5] See ¶10 below.

II. ARGUMENTS FOR REGULATING ENTRANTS' BUILD-OUT PATTERNS

6. The Baumann paper argues that if entrants are allowed to compete without extensive universal service obligations, cable incumbents will be placed at a disadvantage. This will constrain existing operators which may then, possibly, (a) leave some areas under-served, bypassed by technical upgrades; (b) leave some areas unserved, when incumbents exit the cable market altogether; or (c) raise prices in areas where the competitor's system does not extend. In fact, experience in competitive cable markets (which now exist for about 4.4 million U.S. homes[6]) suggests just the opposite: prices fall substantially throughout the area of direct rivalry and sometimes beyond, incumbents rush to upgrade their infrastructure in response to entry, and competition does not result in exit. Bankruptcies have occurred among operators, but on the *entrants'* side.[7] This puts into focus the nature of the disadvantage alleged to rest with incumbents. It also illustrates that, once assets are sunk, competition is long-lived, performing well in lowering consumer prices even after a financial restructuring of an entrant. A new rival may exit, but the rival system continues to provide service to consumers.

7. Do cable incumbents leave some areas under-served when competitive entry is allowed? The Baumann argument is that, when a competitor enters the most lucrative part of a franchise area, it eliminates the monopoly profits necessary to fund service in the least lucrative areas. But the paper then claims, falsely, that the remedy is to impose

[6] BSPs pass approximately 4.4 million households in the U.S.. Broadband Service Providers Association, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Comments of Broadband Service Providers Association,* MB Docket No. 05-255 (Sept. 19, 2005), p. 7.

[7] I here abstract from bankruptcies, like that involving Adelphia in 2002, associated with financial malfeasance of company officials. These instances may suggest something about corporate governance, but not about market structure. *Rigas and Sons Arrested,* CNNMONEY.COM (July 25, 2002), available at http://money.cnn.com/2002/07/24/news/rigas/index.htm.

universal service obligations on the entrant. An entrant that *extended* its coverage to the entire market, as per a universal service mandate, would make the proffered problem *worse* for the incumbent, increasing the scope of price reductions and market share losses. Only if the universal service obligation is seen as a barrier to entry – blocking competition altogether – does it remedy the alleged problem. (A guarantee of cable franchise exclusivity for the incumbent would offer the same outcome. This has the unfortunate attribute of signaling exactly what it is: an anti-competitive policy.) Of course, this is the intended outcome of the policy, as advanced by cable TV incumbents. What is noted here is that the theoretical argument in the Baumann paper rests on precisely this logic, while presenting it as a policy to advance build-out. The policy is just the opposite: a rule to block build-out by the entrant.

8. Given that the status quo defended by the Baumann paper is explicitly facilitated by burdening competitors with uneconomic obligations (raising rivals' costs), the question about technological upgrades is seen in clearer light. It is well-known that cable TV incumbents have responded vigorously to rivalry, upgrading systems to expand capacity and to improve functionality. This has been seen in the industry's response to direct broadcast satellite (DBS) entry in the 1990s,[8] and is seen in current responses to entry into video markets by broadband service providers.[9] These upgrades were prompted by

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[8] "[B]ecause of the intense competition from the direct broadcast satellites launched by Hughes in 1994 and subsequently by EchoStar, cable television operators were forced to spend billions of dollars to upgrade their networks to deliver more programming options." Robert W. Crandall, COMPETITION AND CHAOS: U. S. TELECOMMUNICATIONS SINCE THE 1996 TELECOM ACT, (Brookings Institution Press 2005) ["Crandall 2005"], p. 115. See also Thomas W. Hazlett, Coleman Bazelon, John Rutledge, and Deborah Allen Hewitt, *Sending the Right Signals: Promoting Competition through Telecommunications Reform, A Report to the U.S. Chamber of Commerce* (Sept. 22, 2004), pp. 50-51.

[9] Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming: Twelfth Annual Report,* MB Docket

competitive forces, reversing the policy argument: universal service obligations that block entry leave entire markets under-served. Indeed, the industry's aggressive reaction to DBS is informative, in just this policy context, because DBS entry was originally focused on rural markets, not on "universal service."[10]

9. Do incumbent cable TV systems abandon markets? With over 8,000 cable TV systems[11] operating via about 33,000 franchises,[12] and about 4% of U.S. homes facing a choice between two cable TV operators,[13] the possibility for exit due to competitive market pressures exists. Yet, it is virtually impossible to find such a case where an incumbent system has exited due to competitive rivalry. And, were it to occur, the assets to serve customers would simply be transferred to a new, presumably better, operator, which would continue to provide cable TV subscribers with video signals.

10. There is an obvious financial reason why incumbent cable operators do not and would not abandon assets: the assets are extremely profitable to own. Bauman's theory

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No. 05-255, (Rel. Mar. 3, 2006) ["FCC Twelfth Annual Video Report (2006)"], ¶91; General Accounting Office, *Telecommunications: Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, GAO-04-8 (Oct. 2003) ["GAO (2003)"], p. 10; General Accounting Office, Telecommunications: Wire-Based Competition Benefited Consumers in Selected Markets (Feb. 2004), GAO-04-241 ["GAO (2004)"], p. 13.

[10] "In the mid-1990s, satellite TV companies launched services that targeted people in rural areas that were not served by cable. Once they were established in these regions, companies such as DirecTV and EchoStar's Dish Network took the competition an important step further by offering hundreds of television channels via digital broadcast. 'That's what made cable go out and do its $80 billion upgrade,' said Rob Sanderson, analyst at American Technology Research...." Jim Hu, *Cable, DSL Face Threats*, CNET NEWS.COM (July 29, 2004), available at http://news.com.com/Broadband+Cable,+DSL+face+threats/2009-1034_3-5261385.html.

[11] In 2005, there were 8,400 operating cable systems. TELEVISION & CABLE FACTBOOK (Warren Communications News 2005), p. F-1.

[12] Verizon notes that there are 33,485 cable communities nationwide. Verizon Comments, footnote 3.

[13] BSPs pass approximately 4.4 million households or 4.0% of the 109.6 million television households in the U.S.. Broadband Service Providers Association, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Comments of Broadband Service Providers Association,* MB Docket No. 05-255 (Sept. 19, 2005), p. 7; FCC Twelfth Annual Video Report (2006), Table B-1.

rests on profits becoming shaved so severely that incumbent operators are unable to perform their commitments to serve certain high-cost areas. But, even incorporating such alleged commitments, cable TV systems sell today for about $3,800 per subscriber,[14] while costing less than one-third as much to construct.[15] This suggests that cable systems are highly profitable, and offer strong financial incentives to continue providing service. Moreover, most of the capital costs in cable TV systems are irreversible. As an empirical matter, system abandonment is not a likely outcome, regardless of the rules on entrants.

11. The Baumann paper postulates that cable incumbents will exit upon facing competition from a new rival, but there is no evidence to support this. Indeed, the reaction of incumbents in markets "overbuilt" by rivals is not to flee, which would be quite difficult, given their largely irreversible assets, and quite foolish, given their substantial system values. Instead, we observe incumbents doing precisely the opposite: upgrading facilities, expanding offerings, and lowering their prices.[16]

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[14] The average market value of cable systems sold in 2004 was $3,906 per subscriber, and $3,786 per subscriber in 2005 (January through May sales). See Kagan Research, LLC, BROADBAND CABLE FINANCIAL DATABOOK 2005 (Kagan Research, LLC 2005) ["Kagan 2005"], p. 174. Robert Crandall reports per subscriber values equal to about $4000 in 1996 and approximately $5000 in 2003. Crandall 2005, p. 164.

[15] This estimate is based on reported data for a proxy for capital costs, the depreciated value of property, plant and equipment. This value averaged $1,055 per subscriber in 2004 for Cablevision Systems, Charter Communications, Comcast Corporation, Cox Communications, General Communications Inc., Insight Communications, Mediacom and Time Warner Inc. Calculations based on Kagan 2005, pp. 22, 126.

[16] FCC Twelfth Annual Video Report (2006), ¶91; GAO (2003), p. 10; GAO (2004), p. 13.

III. Policy Evaluation

12. The Baumann paper asserts that cable operators are subject to universal service mandates.[17] This is highly misleading. First, cable TV franchises routinely excuse incumbents from offering service in high cost, low density sub-markets. For example, a standard franchise term exempts neighborhoods of less than 30 homes passed per mile in the incumbent's regulated build-out. Second, cable operators are not required to provide service to all customers; at most, they must offer to provide service to households within their franchise area for a standard charge. This contrasts sharply with universal service obligations in other markets, such as telecommunications, which the Baumann paper suggests as an analogy.[18] There, mandates have historically compelled carriers to make service available at regulated rates to all residents. For decades, over 90% of households have subscribed to these services.[19]

13. Third, the actual construction pattern seen in cable television markets indicates that construction schedules have not been strictly regulated. In an analysis of all California cable TV systems reporting data for the year 1986, I found that the large majority of systems reported build-out patterns that were substantially longer than five years.[20] This is consistent with press coverage in myriad communities, reporting that cable franchise agreements have been characterized by delays and enforcement

[17] "Existing franchise agreements generally require a cable system to serve most or all of the households in its franchise area. If franchising authorities maintain this universal coverage condition…." Baumann, p. 2. "If regulators want to maintain universal service…." Baumann, p. 3.

[18] Baumann, p. 3.

[19] "Since 1970, over 90% of households and virtually all businesses have subscribed to telephone service." Wireline Competition Bureau, *Trends in Telephone Service,* FEDERAL COMMUNICATIONS COMMISSION (June 2005), p. 7-1.

[20] Thomas W. Hazlett, *Cable TV Franchises as Barriers to Video Competition*, GEORGE MASON UNIVERSITY RESEARCH PAPER No. 06-06 (Mar. 5, 2006), pp. 42-45.

problems.[21] In addition, many current cable TV systems were originally constructed without any build-out requirements, owing to the fact that they were built without cable franchises. This was fairly common prior to the Cable Act of 1984, which imposed a franchise requirement. In a survey of Pennsylvania cable TV systems in 1982, researchers at Pennsylvania State University found that about 16% of the state's systems were then operating without municipal cable franchises.[22]

14. It is an empirical question as to how heavily the burdens of their own build-out obligations fall on cable incumbents. Given lax enforcement and exemptions from building out sparsely populated areas, incumbent cable TV operators' burdens may be inexpensive. What is not in doubt, however, is that nominally symmetric build-out requirements on entrants are far more expensive. That is because the entrant faces a market with an established incumbent, anticipating market share of only about one-half of the wireline video customers and prices about 15% to 20% below the incumbent's pre-entry price. Financially, the burdens of build-out can become highly unprofitable when competition replaces monopoly. Incumbents fully agree with this analysis, which is why they insist on "most favored nations" clauses in franchises, or threaten to renege on franchise obligations should the local government allow a rival to compete on terms that allow economic entry. This is precisely the point of the Baumann paper, in fact, when it argues that incumbent monopoly cable systems cannot afford to subsidize various services should their exclusive franchise status give way to competition. The argument is

[21] See, e.g., my report on the long delays in the Washington D.C. cable market. Thomas W. Hazlett, *Wired: The Loaded Politics of Cable TV*, 200 THE NEW REPUBLIC (May 29, 1989), pp. 11-13.

[22] D. Allen & D. Kennedy, *Municipal Regulation of Cable Television in the Commonwealth of Pennsylvania 3-11*, PENNSYLVANIA STATE UNIVERSITY, INSTITUTE OF PUBLIC ADMINISTRATION (Dec. 1982).

couched in terms of fairness, focusing on entrants with "asymmetric" obligations, but it is not the symmetry of the obligations that reduces the incumbent's profits, but competition.

IV. ECONOMIC THEORY

15. The Baumann paper sees competition – which forces efficiencies, pushing prices to costs – as a problem: "[I]t allows new entrants to a market to 'cream skim' the low cost (or high value) customers…."[23] And this is exactly the situation here, where prices have been found to be substantially higher in non-competitive markets, dropping 15%-20% or more with competitive entry.

16. The loss of profits adversely affects a firm, and so here the erstwhile cable monopolist. Such a firm can always assert that it will produce an inferior output as a result. Indeed, regulatory agreements such as cable TV franchises are mechanisms whereby franchisees tie their financial fortunes to the "public interest," a process explained by Richard Posner's important work, *Taxation by Regulation*.[24] Consumers are taxed by monopoly market structures, allowing franchisees to charge higher prices. The firm benefiting from such barriers commits, in return for such economic protection, to devote some fraction of their rents to projects important to regulators. This system of cross-subsidies is highly inefficient both because it relies on hidden taxes that are difficult to properly evaluate in terms of their costs and benefits, and because the creation

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23 Baumann, p. 4.

24 Richard A. Posner, *Taxation by Regulation*, 2 BELL JOURNAL OF ECONOMICS AND MANAGEMENT SCIENCE 22 (Spring 1971).

of monopoly is an extremely expensive, economically distortionary, manner in which to raise funds for public purposes.

17. Supporting franchise regulation that places barriers in the path of entrants is then recommended because it protects monopolistic market structures, just the reverse of what efficient, pro-consumer policies aim to achieve. The Baumann paper makes just this argument, writing that if low barriers to entry obtain, "[i]ncumbent cable operators will be less willing to pay franchise fees; to provide public, educational, and governmental channels; and to provide financial support for those channels."[25] Of course, were universal service rules for entrants to actually promote additional service, then the market would become *more* competitive with such mandates. When Baumann claims that allowing entrants to freely compete "will change the incumbent's incentives and may jeopardize the financial solvency of the incumbent,"[26] he exposes the anti-competitive effect of such laws. Cable incumbents would be *less* willing to share rents given universal service obligations on entrants that *expand* the scope of rivalry; instead, his argument reveals that such measures are anticipated to *restrict* rivalry, thus increasing incumbents' profits.

18. The Baumann paper is exclusively concerned with the level of cable incumbents' profits: "lower profits will diminish the incumbent's ability and incentive to maintain and upgrade service."[27] It excludes consideration, therefore, of the bigger part of the story: consumers' interests in competition. Whatever the alleged losses ensuing from reduced

[25] Baumann, p. 9.
[26] Baumann, p. 6, footnote omitted.
[27] Baumann, p. 6.

incumbent profitability, the gains from competitive entry are substantial, as shown in repeated studies and surveys including those conducted by the FCC.[28] Indeed, these consumer gains relate not just to price and quality improvements, but to technology upgrades and wider availability of services. That is to say, competition is an alternative mechanism for promoting technology deployment. When cable operators face new rivals, they are often seen to race to serve unserved areas – in some cases, areas that were neglected for years prior to the emergence of competition – and to adopt more advanced technologies.

V. POTS POLICY

19. The Baumann paper notes that universal service "requirements... have been applied to other industries such as electric power and telecommunications,"[29] but fails to note that entrants into telecommunications have not been burdened with build-out requirements. Indeed, cable TV operators have argued against such regulation. Rather than adopt "symmetric" regulation that would inflict intrusive common carrier and provider-of-last-resort obligations on competitive local exchange carriers (CLECs), cable TV operators have strongly favored "asymmetric" regulation.

20. This conclusion is surely correct: it is widely agreed that entrants into the voice market should not be burdened with anti-competitive barriers, such as build-out obligations. While free entry can (and has) threatened to disrupt particular universal

[28] Federal Communications Commission, *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment, Report on Cable Industry Prices*, MM Docket No. 92-266 (Rel. Feb. 4, 2005).

[29] Baumann, p. 3.

service policies, the rational response is to (a) invite competition, without barriers, and (b) achieve technology deployment goals with policies adapted to competitive markets. This is precisely what should happen in cable. Competition should not be thwarted by anti-competitive barriers designed to protect monopoly funding sources for (alleged) universal service goals.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on March 28, 2006

Thomas W. Hazlett

Federal Communications Commission

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